IN THE

Supreme Court of the United States

OCTOBER TERM, 1956

No. 251

SCHENLEY DISTILLERS, INC., and JOSEPH S. FINCH AND COMPANY,

Petitioners,

against

THE UNITED STATES OF AMERICA,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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THE UNITED STATES OF AMERICA,

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PETITION FOR WRIT OF CERTIORARI.

Petitioners, Schenley Distillers, Inc. and Joseph S. Finch and Company, pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit, affirming a judgment of the United States District Court for the Western District of Pennsylvania.

Opinions Below.

The opinion of the Court of Appeals is unreported as yet, and is printed together with the judgment of the Court as Appendix A hereto. The opinion of the District Court is reported in 153 F. Supp. 898 (W. D. Pa. 1957), and is printed in Appendix B hereto.

Jurisdiction.

The judgment of the Court of Appeals was entered on May 8, 1958. The jurisdiction of this Court is invoked under 28 U. S. C. Section 1254(1) (1952 ed.).

Questions Presented.

The petitioners' complaint in this suit seeks the refund of certain Internal Revenue taxes on distilled spirits, paid by the petitioners, on the ground that the particular provision of the Internal Revenue Code under which the taxes were exacted is unconstitutional. The District Court dismissed the complaint for failure to state a claim, on the ground that the challenged provision is constitutional, and the Court of Appeals affirmed. The questions presented by this petition are the following:

I. Did the challenged provision of the Internal Revenue Code impose an unapportioned direct tax on property, in violation of Article I, Section 2, Clause 3 and Article I, Section 9, Clause 4 of the Constitution of the United States?

II. Were the petitioners, by virtue of the challenged provision of the Internal Revenue Code, deprived of their property without due process of law, in violation of the Fifth Amendment to the Constitution of the United States?

Statutes Involved.

The statutes directly involved are Section 5006(a)(2) of the Internal Revenue Code of 1954, 26 U. S. C. §5006(a)(2) (Supp. V, 1958); Section 5061(a) of the Internal Revenue Code of 1954, 26 U. S. C. §5061(a) (Supp. V, 1958); and

Section 451(a) of the Revenue Act of 1951, 65 Stat. 524. The full texts of these and other relevant statutes are set forth in Appendix C hereto. The provisions of the Constitution of the United States which are involved are Article I, Section 2, Clause 3; Article I, Section 9, Clause 4; and the Fifth Amendment, the texts of which are also set forth in Appendix C.

Statement.

This is a suit for refund of certain distilled spirits taxes paid by the petitioners to the United States government. The taxes were exacted from the petitioners by virtue of a phrase in the Internal Revenue Code which forces the payment of a 500% tax on distilled spirits ($10.50 tax as against $2.11 value), at an arbitrary point of time when there is no market for the spirits—and even though it is a foregone conclusion, at the time of the tax payment, that substantial amounts of the tax-paid spirits will inevitably evaporate and never will be sold.

This phrase, requiring the tax payment and withdrawal of spirits eight years after entry thereof into a warehouse where they are required by law to be put, is known as the "force-out" provision.*

The petitioners' principal contention is that the tax when exacted at this arbitrary point of time, unrelated to

* The challenged phrase is italicized in the following quotation from the Internal Revenue Code of 1954:

"Sec. 5006. Determination of Tax.

"(a) Requirements.—

• • • • • •

(2) Distilled spirits deposited in internal revenue bonded warehouses.—The tax on distilled spirits entered for deposit in internal revenue bonded warehouses shall be determined at the time the same are withdrawn therefrom *and within 8 years from the date of original* entry for deposit therein • • •"

any excisable transaction or event, is a direct tax on the property itself. Not being laid in proportion to the census or apportioned among the several states according to their numbers, it is contrary to Section 2 and Section 9 of Article I of the Constitution of the United States.

The issue is a novel one. The validity of the challenged force-out provision has never before been passed upon by the Courts.* The decision below is contrary to the clear import of this Court's landmark decision in *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429 (1895), *rehearing*, 158 U. S. 601 (1895), and contrary to every relevant decision of this Court since then. Resolution of this unsettled question of federal law is of the gravest importance not only to the petitioners but to the entire distilling industry, to the Treasury and to the public generally. The impact of the challenged force-out provision goes far beyond the refund sought. The provision inflicts huge damage and destruction upon the entire distilling industry, the great bulk of which is not compensable in any refund or other action. And the Treasury, a 52% partner in those losses, also loses greatly—to the extent of hundreds of millions of dollars in recent years.

To illustrate the impact of the force-out provision as a prohibited direct tax upon the property, by reference to a particular one of the series of tax payments involved in the case:

In 1945 the petitioners distilled some whiskey. It was of course raw and unpalatable. In order to age it and make it fit for consumption, the petitioners in usual course put it

* Prior to bringing this present suit the petitioners had sued to enjoin the imposition of the tax; and a special three-judge court, without going into the merits, had held that, purely as a procedural matter, it had no power to enjoin. *Schenley Distillers, Inc. and Joseph S. Finch and Company* v. *Bingler*, 145 F. Supp. 517 (W. D. Pa. 1956). This Court affirmed. 353 U. S. 933 (1957).

into barrels—as the law commanded them to do. They deposited the barrels in an Internal Revenue bonded warehouse—again as the law commanded them to do.

The petitioners paid no tax at that time. None was payable.

Eight years later, in August 1953, the barrels of whiskey were still in the warehouse. The petitioners were doing nothing with it. They were not bottling it, or taking any other step preparatory to putting it on the market. They had no market for it. The whiskey was simply part of the petitioners' inventory of property in the warehouse, sitting in the warehouse because the law had commanded them to put it there, after distillation eight years earlier.

The petitioners were nevertheless forced, in August 1953, to pay the $10.50 per gallon tax on that whiskey. They were forced to pay, by virtue of the force-out provision, solely because the property was there on the tax date. If it had not been there on the tax date—if the petitioners had poured it down the sewer before that date, or redistilled it (suffering an 80% loss of values) or exported it (for a fraction of its value)—there would have been no tax.*

The payment of the tax, of course, created no market for the whiskey. The petitioners still had no market for it. And it was a foregone conclusion, when the tax was exacted and paid, that substantial amounts of the whiskey never could or would be sold: the tax-paid whiskey would inevitably continue to evaporate from the barrels.

That was exactly what happened. When the petitioners finally found a market, more than three years later, almost 30 gallons of the 334 gallons of tax-paid whiskey had

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*Internal Revenue Code of 1954, Sections 5011, 5194 (f), 5247 (App. C, pp. 5-6, 11-13).

evaporated and been lost forever—along with the 500% tax levy paid thereon.*

In respect of such evaporated gallons, the petitioners seek a refund of the entire amount of the tax. That amount —$10.50 per gallon—was made up of two components: (a) a $9.00 tax which was on the books when the whiskey was distilled,** and (b) an additional tax of $1.50 per gallon which was enacted long after the spirits had been distilled***—six years later, in the case of the 10 barrels mentioned above.

The courts below held that the $9.00 part of the tax was levied when the spirits were distilled, that it was only the collection thereof which was postponed for eight years, and that the $9.00 part of the tax was therefore an excise on the original act of distillation and not a direct tax on the possession and ownership of the property at the time the tax was exacted and paid.

The petitioners think that this "distillation tax" theory is wrong; and they wish to present their position on that point in full detail, in their brief and in oral argument. But the important point at the outset is that, whatever its merits or demerits, the "distillation tax" theory has no conceivable application in respect of the additional tax of $1.50 per gallon—a tax which was not on the books when the spirits were distilled, and could by no stretch of the imagination be said to have been levied in respect of the distillation of the spirits. (This latter claim, for refund of the additional tax of $1.50 per gallon, is made in respect of both the evaporated gallons and all other gallons which were tax-paid by reason of the force-out provision. It constitutes by far the major part of the petitioners' claim in this case.)

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* Complaint, pars. 12-16. The complaint, having been printed in the appendix to petitioners' brief before the Court of Appeals below, is a part of the appendix record before this Court (filed pursuant to Rule 21(3) of the Rules of this Court).

** Revenue Act of 1943, Section 302(a), 58 Stat. 61.

*** Revenue Act of 1951, Section 451(a), 65 Stat. 524.

This additional tax of $1.50 per gallon, exacted at the arbitrary force-out tax payment date, was totally unrelated to any excisable transaction or event, past, present or prospective. Distillation had occurred and been completed years before; nothing was being done at the time the payment was exacted; and marketing, at best a faint future hope, in fact never did occur with respect to that substantial part of the whiskey which later evaporated. In short, the additional $1.50 tax was upon the property itself.

The petitioners wish to emphasize that this case is not an attack on the general federal system of taxation of distilled spirits or on the tax itself. Striking out the one unconstitutional phrase—the 13-word force-out provision—would leave the balance of the tax structure unimpaired. Then the taxes, instead of being unconstitutionally levied on the mere ownership and possession of the distilled spirits at an arbitrary point of time, would be levied when the spirits are withdrawn for sale, an excisable act, precisely as in the case of the federal tobacco taxing scheme.

Nor will the striking out of the unconstitutional force-out provision in any way impair the power of the Congress to increase the rate of tax in respect of spirits already distilled. The Congress will have the full power to do that, and to collect the amount of the increase in conjunction with marketing or any other excisable act.

Nor will there be any unjust enrichment of the petitioners. They will be entitled to recover only those amounts which were direct taxes upon the property itself. They will not be entitled to recover any amounts which were passed on to others and thus operated as indirect or excise taxes. The Congress has recently enacted a statute (sponsored by the Treasury as a result of this present suit) putting upon anyone claiming a refund of distilled spirits taxes the burden of proving that the taxes were not passed on to others.*

* P. L. 85-323, 85th Cong. 2d Sess. (1958).

Reasons Relied Upon for Granting the Writ.

I. The Force-out Provision Imposes an Unconstitutional Direct Tax on Property.

More than 60 years ago, in the *Pollock* case (page 4 above), this Court settled once and for all that the Constitutional prohibition against unapportioned direct taxes applies to federal taxes on property of any kind, whether real or personal. That fundamental protection for property has been rigorously applied since then in every case where, as in the present case, the impact of a federal tax was upon the very possession and ownership of property.

In *Eisner* v. *Macomber*, 252 U. S. 189 (1920), this Court (holding that a stock dividend was not income within the meaning of the Sixteenth Amendment) struck down a stock dividend tax as an unapportioned direct tax upon the property itself. In *Pierce* v. *United States*, 232 U. S. 290 (1914), this Court (by reference to its opinion in the companion case of *Billings* v. *United States*, 232 U. S. 261 (1914)), held that a federal tax on the "use" of a yacht could not (in the light of the Constitutional prohibition against direct taxes and the *Pollock* decision relating thereto) be construed as permitting a levy on a yacht which had merely been owned or possessed, and not actively used, during the tax period. In *Frick* v. *Lewellyn*, 298 Fed. 803 (W. D. Pa. 1924), *aff'd on other grounds*, 268 U. S. 238 (1925), life insurance proceeds were the property held by the Federal courts to have been subjected to an invalid direct tax. Also, within the past three years, a provision of the Federal Estate Tax Law was held unconstitutional because it purported to levy an unapportioned direct tax on the very possession and ownership of the proceeds of life insurance

policies. *Kohl* v. *United States*, 226 F. 2d 381 (7th Cir. 1955).

Conversely, this Court has upheld as excises only those taxes which—unlike the one here involved—were levied in respect of a specified actual transaction or a particular active use of property, and not upon the mere possession and ownership thereof. For example, in *Nicol* v. *Ames*, 173 U. S. 509 (1899) and *Thomas* v. *United States*, 192 U. S. 363 (1904), the thing taxed was not the property, but actual sales thereof. In *Knowlton* v. *Moore*, 178 U. S. 41 (1900), the tax was levied upon the transmission of the property from the dead to the living. In *Fernandez* v. *Wiener*, 326 U. S. 340 (1945), the thing taxed was a series of changes in particular interests in property, consequent upon death in a community property state. In *Bromley* v. *McCaughn*, 280 U. S. 124 (1929) the tax was upon gifts of property. In *Flint* v. *Stone Tracy Co.*, 220 U. S. 107 (1911), the thing taxed was not the possession and ownership of property, but the doing of business in a corporate capacity.

This Court has in every case looked to the basic impact of the tax; and where, as here, that has been upon the property itself, the tax has in each case been stricken down—however adroit the "excise" terminology advanced in support of it. For example, in the *Pierce* case (page 8 above) the government contended (and the lower court in that case had agreed) that the unused yacht had a "potential use" or "privilege of use" upon which an unapportioned excise could be levied. This Court summarily rejected the contention, pointing out that such attributes were necessary concomitants of ownership of property as such. In the *Pollock* case (page 4 above) the government argued that a tax on income was simply an assessment upon the taxpayer on account of his money-spending power, and not a tax upon property. Looking to the basic impact of the tax,

this Court pointed out that the tax was "imposed merely because of ownership and with no possible means of escape from payment"; and the government's contention was rejected in the following passage:

> "There can be but one answer, unless the constitutional restriction is to be treated as utterly illusory and futile, and the object of its framers defeated. We find it impossible to hold that a fundamental requisition, deemed so important as to be enforced by two provisions, one affirmative and one negative, can be refined away by forced distinctions between that which gives value to property, and the property itself."*

The petitioners respectfully submit that the contentions advanced by the government in this present case, and adopted by the courts below, are of a piece with those rejected by this Court in the *Pollock* and *Pierce* cases. The Constitutional protections against any property taxes except in accordance with representation are rendered futile and meaningless, if they can be circumvented by such far-fetched theory, so unrelated to reality, as that employed in the decision below.

The challenged additional $1.50 was not conceivably (as the court below held) exacted by the Congress in respect of distillation. The fact of distillation was quite immaterial in the levying of the tax: millions of gallons, distilled at the same times as the whiskies here involved but withdrawn earlier, incurred no such tax. The sole basis for the levying of the $1.50 tax, the sole test of taxability, was the existence of the whiskey in bond on a force-out date after the November 1, 1951 effective date of the taxing statute.

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*158 U. S. at p. 628.

And if, contrary to the fact, the Congress had tried to levy the $1.50 tax as an additional tax on distillation, it would have been unconstitutionally retroactive. *Nichols* v. *Coolidge*, 274 U. S. 531 (1927); *Blodgett* v. *Holden*, 275 U. S. 142 (1927); *Untermyer* v. *Anderson*, 276 U. S. 440 (1928); *Helvering* v. *Helmholz*, 296 U. S. 93 (1935); *White* v. *Poor*, 296 U. S. 98 (1935). In each of those cases this Court struck down, as unconstitutionally retroactive, federal tax statutes which attempted to change the tax consequences of completed acts. And none of them, it should be noted, involved anything like the eight years of retroactivity sanctioned by the court below in this present case.

The court below cited none of the foregoing clear-cut decisions of this Court. Instead, the court below advanced a suggestion that the $1.50 tax was foreseeable, and on that basis reached a rather tentatively stated conclusion to the effect that the tax accordingly "seems" to be supportable.

The lower court's "foreseeability" premise totally ignores the facts in this case. What was "foreseeable"—as shown in detail in the complaint—was a tax *decrease*, not an increase. The petitioners had every reason to expect a decrease in the tax rate (and a consequent increase in whiskey consumption); and it was in the light of that expectation that they distilled the amounts they did.*

That is a far cry from *Wilgard Realty Co.* v. *Commissioner*, 127 F. 2d 514 (2d Cir. 1942), one of the two cases cited in the opinion below.** In that case, as the court there found, the later statute had merely put back into effect (after an intervening court decision the other way) the very rule upon which the taxpayer had relied from the

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* Complaint, pars. 34-42.

** The other of the two cases cited in the opinion below, *Milliken* v. *United States*, 283 U. S. 15 (1931), involved a tax measure designed to prevent avoidance of estate taxes, which are always levied at the rate in effect at the date of death. The case is in no way inconsistent with the petitioners' position here.

outset. His expectations were not (as in the present case) defeated by the later statute; they were in fact confirmed. And in the above cited *Untermyer* case (not mentioned in the opinion below) the enactment of the very tax was "foreseeable", almost to a certainty, at the time of the transaction involved. The bill containing the tax had been passed by both the House and the Senate and sent to and reported out by the conference committee, when the taxed transaction was entered into. Despite these circumstances, this Court struck down the retroactive feature of the tax as unconstitutional.

Likewise divorced from any reality, in law or in fact, is the holding below to the effect that the $1.50 tax was an excise on the "privilege" of "holding" spirits in bond.

There was no tax on "holding". The amount of the tax bore no relation to the time the spirits were held in bond. The tax was precisely the same—$1.50 per gallon—whether the whiskey was "held" after November 1, 1951 for one minute or for eight years. This very point was decided, contrary to the conclusion of the court below in this present case, in *Dawson v. Kentucky Distilleries Co.*, 255 U. S. 288 (1921). That case, like the present one, involved a tax on distilled spirits. There as here the amount of the tax was the same, regardless of the length of time the whiskey was stored. The tax was payable, as this Court pointed out at page 293, even though "there had not been storage for any appreciable time." For that reason, this Court in an unanimous opinion by Mr. Justice Brandeis held that the tax could not be sustained as an excise on storage, and it was stricken down as an unconstitutional property tax. *Nicol v. Ames*, 173 U. S. 509 (1899), the sole authority cited by the court below, affords no support for the court's conclusion. That case involved a tax upon actual sales of property, upon an exchange, and not a tax upon the mere holding of the property.

Nor is the holding of whiskey in bond in any sense a "privilege". The law commanded the petitioners to put their whiskey in the warehouse. The law commanded them to keep it there until they had a market. If they took it out, they had to pay a 500% tax thereon—and obviously they could not do that until they had a market for the whiskey so as to pass the tax on. The decision below, on this point, turns upon the totally unrealistic idea that all of the whiskey in bond could have been withdrawn immediately before the November 1, 1951 effective date of the $1.50 tax—and that tax thus avoided. On the government's own figures, cited to the courts below, there were 700,000,000 tax gallons of spirits in bond in the United States at that time. The tax, at the old rate of $9.00 per gallon, would have been in excess of $6,000,000,000, or more than four times the aggregate amount of all net assets of the entire domestic whiskey industry.*

In sum, the additional tax of $1.50 per gallon, when exacted by virtue of the challenged force-out provision, was a tax upon the property and nothing else. The decision below, clothing the tax in "excise" terminology which has no foundation in law or in fact, would render the direct tax provisions of the Constitution futile and meaningless. The decision should not be permitted to stand.

II. Resolution of the Unsettled Direct Tax Question is of Grave Importance to the Entire Distilling Industry, to the Treasury and to the Public.

The unsettled direct tax question discussed above is of great importance, in and of itself. Resolution of that

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* As stated in paragraph 51 of the complaint, the aggregate amount of all net assets of the 85% of the domestic whiskey industry, for which figures were available, was only about $1,200,000,000. On that basis the net assets of the entire domestic industry were only about $1,400,000,000.

question, however, becomes of greatly increased importance when the broader impact of the challenged force-out provision is considered.

The refund sought represents but a small segment of the harm suffered by the petitioners and other members of the distilled spirits industry by reason of the unconstitutional force-out provision. The great bulk of the damage and destruction inflicted upon them by this provision is not compensable in a refund action or otherwise. In order to avoid the bankruptcy which would inevitably follow the payment of this 500% levy in respect of any substantial part of its force-out whiskey,* the industry has no choice but to export the whiskey for a fraction of its value or to dump it on the market for what little it will bring, or simply to destroy it.** The petitioners alone, in the year 1956 alone, and in the Pittsburgh Internal Revenue District alone, were thus forced to destroy nearly $1,000,000 worth of whiskey.*** Under the impact of the force-out provision in recent years, bulk whiskey prices have collapsed, the market value of whiskey inventories has fallen to one-third the former level and there has been a 69% loss of profits.†

None of that huge loss represents any gain to the Treasury or the public. Quite the contrary, the Treasury has in fact lost not only the taxes on the exported and destroyed whiskies, but also huge amounts of corporate income taxes—hundreds of millions of dollars over the past several years; and in the ensuing years it will lose even more.††

Thus the tax-paying public in general, as well as the entire distilling industry, has a deep interest in the prompt

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*E. g., on the Treasury's own figures, the tax liability on the force-out faced by the industry, for the years 1955 and 1956 alone, was $1,225,000,000—and the whole net worth of the entire industry barely equals that amount. Complaint, par. 51.

** Complaint, pars. 52-58.

*** Complaint, par. 57.

† Complaint, pars. 60-64.

†† Complaint, par. 94.

resolution of the important federal questions presented in this case.

It is the petitioners' position (which they will wish to present in detail in briefs and argument before this Court) that the damage and destruction inflicted by the force-out provision, without any public benefit or justification whatsoever, renders that provision unconstitutional on the wholly separate ground that it deprives the petitioners of their property without due process of law. It is respectfully submitted that this cannot be brushed aside, as it was by the court below, on the ground that the business situation, and not the force-out provision, caused the damage. Absent the force-out provision, the damage and destruction would not have been suffered. The complaint clearly shows that, and nobody questions it.

Conclusion.

It is respectfully submitted that this Court's writ of certiorari should issue.

Respectfully submitted,

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Dated: August 6, 1958.

Appendix A.

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

No. 12,409

SCHENLEY DISTILLERS, INC., AND
JOSEPH S. FINCH AND COMPANY,
Appellants

v.

UNITED STATES OF AMERICA

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF PENNSYLVANIA.

Argued March 6, 1958

Before BIGGS, *Chief Judge*, and GOODRICH and MCLAUGHLIN, *Circuit Judges*.

OPINION OF THE COURT.

(Filed May 8, 1958)

By GOODRICH, *Circuit Judge*.

This appeal is from a judgment of the District Court for the Western District of Pennsylvania dismissing a complaint by the plaintiffs to recover certain distilled spirits taxes paid by them, 153 F. Supp. 898 (W.D. Pa. 1957). There are two reasons set forth for claiming the refund. One is that the tax is a direct one which was not apportioned. The other is that the imposition of the tax violated due process of law. Both of these reasons are grounded in part upon the operation of what is called the "force-out" provision.

Since the complaint was dismissed because the court thought it did not state a claim upon which relief could be granted, we shall take the allegation of facts there as correct for the purpose of this appeal.

The plaintiffs are distillers of whisky. It costs them about ninety-five cents to distill a gallon of whisky and put it in a barrel. However, this type of spirits is unfit for consumption until it has been aged for at least four years during which time there is quite a bit of evaporation. To provide for this commercial necessity, the tax imposed by the United States need not be determined and paid until withdrawal from a bonded warehouse which, under the law, must take place within eight years from the date of storage therein.[1] By the end of eight years interest, insurance, warehousing and evaporation bring the cost up to $2.11 a gallon. At the time the whisky in question in this case went into storage, between 1943 and 1947, the rate of taxation was $9.00 on each gallon.[2] In 1951 an additional $1.50 was imposed.[3] It will be noted that the taxes are many-fold the cost of the whisky itself.

As a tax upon the voluntary withdrawal of the spirits from bond, the plaintiffs do not complain of its legality whatever they may think of the desirability of having it so high. Under normal circumstances they bottle the whisky after withdrawal and sell it within sixty days, passing the tax, of course, on to the consumer. But the difficulty now is that since 1951 there has been a tremendous oversupply in the industry. Therefore, although the plaintiffs must pay the tax after eight years of storage, as they decided to do in this instance, they cannot sell the whisky withdrawn for the market until years later and then at ruinous prices which bring only a fraction of the tax cost, let alone any profit for

[1] INTERNAL REVENUE CODE OF 1939, §5006(a)(2) (hereinafter cited as I. R. C. 1939); INTERNAL REVENUE CODE OF 1954, §5879(b) (hereinafter cited as I. R. C. 1954).

[2] Revenue Act of 1943, c. 63, §302(a), 58 STAT. 61.

[3] Revenue Act of 1951, c. 521, §451(a), 65 STAT. 524.

the distillers. They can prevent exaction of this high rate by exporting[4] or sale for nonbeverage purposes,[5] again risking a glutted market and low prices, or by total destruction[6] or redistillation[7] within the eight-year period. In order to avoid this dilemma, the plaintiffs are attempting here to have this time requirement deleted from the statute on the ground that its presence makes the tax unconstitutional.

Narrowly, the plaintiffs seek to recover on two claims. The main one is to get back $1.50 for each gallon forced out during the four-year period from November 1, 1951 to September 30, 1955, the latter being the date of their refund claims. This amount, constituting 99.6% of the refund sought, was paid with respect to the increase in the tax enacted after the plaintiffs' whisky had been put in the warehouse. The plaintiffs assert that this portion is clearly a direct property tax and as such is valid only if apportioned, relying on the well-known income tax case of *Pollock v. Farmers' Loan & Trust Co.*, 157 U. S. 429, *rehearing*, 158 U. S. 601 (1895).

It is their contention that to be classified as indirect a tax must be levied either in circumstances where it can and will be passed on to the consumer or in connection with an actual transaction, specified privilege or particular active use of the property other than the mere possession or ownership thereof. By no stretch of the imagination, they say, can this increase be called an excise on the act of distillation which took place before it was enacted. Furthermore, they argue, the tax bears no reasonable relationship to the marketing transaction because at the time it was paid there was no certainty when a sale would be made, if at all.

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[4] I. R. C. 1939, §2885(a); I. R. C. 1954, §5247(a). See also I. R. C. 1954, §5248(2)-(4).

[5] I. R. C. 1939, §§3070(a), 3250(1); I. R. C. 1954, §§5131, 5522.

[6] I. R. C. 1939, §2901(a)(2); I. R. C. 1954, §5011(b).

[7] I. R. C. 1939, §2883(e); I. R. C. 1954, §5194(f).

Following this analysis, the plaintiffs urge that the 1951 increase of $1.50 was charged solely by virtue of their ownership of the spirits and, due to the disaster prices at which this stock was merchandised, was not retrievable through sale.

The second claim for relief comes for a refund of the full amount of the taxes paid between the two dates above mentioned for that part of the whisky withdrawn under the eight-year provision which they say they can show never became salable because of the continued loss by evaporation and shrinkage before a market became available.

It is conceded that Congress could have enacted a distillation tax. It is also conceded that the $9.00 rate, in effect when the spirits went into storage, could have been enacted as such a measure. But the plaintiffs urge the structure of the 1939 and 1954 Internal Revenue Codes makes it obvious that Congress did not enact a distillation tax because at distillation the amount of tax was not ascertainable. Stressed in support of this argument are the facts that the tax is determined only as to those gallons which have not evaporated[8] nor been disposed of in certain enumerated ways[9] before payment is required and then only at the rate prevalent at that time. Therefore, they contend that even this amount, as applied to spirits forced out, bears the same infirmity of directness as the $1.50, although they evidently do not dispute the assumption that this sum was passed on to the consumer on eventual sale.

As will be noted the attack on the "force-out" clause depends on having to support the spirits tax as being one on the sale to the consumer. We do not believe that this is necessary and, therefore, reject the plaintiffs' argument. No one doubts, we suppose, that a valid excise can be placed on the distillation of spirits. There are certain features in both the 1939 and 1954 Internal Revenue Codes which indi-

[8] I. R. C. 1939, §2901; I. R. C. 1954, §5011(a).

[9] See notes 4-7 *supra*.

cate to us that this is exactly what Congress intended to do. The tax is "levied"[10] or "imposed"[11] on "all distilled spirits . . . produced in . . . the United States" and attaches "as soon as this substance is in existence as such."[12] When the whisky is not, as required by statute, placed in the warehouse, payment is required immediately.[13] These elements seem sufficient to classify all exactions made thereunder as indirect production taxes. In this view we are supported by the recent Court of Claims opinion in *Erie R. R.* v. *United States*, 156 F. Supp. 908 (1957). See also *Thompson* v. *United States*, 142 U. S. 471 (1891).

We are not persuaded that the factors to which the plaintiffs point affect the impact of this tax as an excise. The allowances for evaporation, loss, redistillation and exportation and the lower rates afforded for industrial uses all appear to be in the nature of relief provisions designed to meet the peculiar technical and economic problems of the distilling industry. The contention that it was not certain that the rate which attached at distillation was the one which would be paid because the legislature customarily makes new rates apply to that whisky previously produced does not change the fact that the tax accrued immediately and had to be paid within the specified time whether the rate was changed or not.[14]

What has been said above clearly sustains the $9.00 tax as an excise on distillation notwithstanding the "force-out" clause. Can the rate be increased without violating any

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[10] I. R. C. 1939, §2800(a)(1).

[11] I. R. C. 1954, §5001(a)(1).

[12] I. R. C. 1939, §2800(c); I. R. C. 1954, §5001(b).

[13] I. R. C. 1939, §2800(b)(2); I. R. C. 1954, §5006(c).

[14] Even this practice is based on the necessity of preventing the speculation that would take place if distillers holding whisky taxed at a lower rate would be entitled to compete with those who distilled after an increase had been enacted. See HOWE, TAXATION AND TAXES IN THE UNITED STATES 151-52 (1896), commenting on the conditions existing before tax rate increases were made retroactive.

constitutional provision? We think it can. An examination of American fiscal history will show that whisky, as a commodity, was taxed as early as 1791,[15] and that the scheme of taxation developed in the years following the Civil War has been in effect continuously, except for prohibition, to the present time. From their argument pertaining to the original rate it is obvious that the plaintiffs were aware that ever since 1894 whisky held in bond has been made subject to the new rates which are enacted from time to time. They themselves admit "nobody knew at distillation what the rate of tax would be upon withdrawal." If Congress, during the eight-year period given in which to pay the tax due, makes it $10.50 instead of $9.00 while maintaining the same general tax structure, that seems to come within the general rules which the courts have laid down with respect to the legality of retroactive provisions. See *Milliken* v. *United States*, 283 U. S. 15 (1931); Cf. *Wilgard Realty Co.* v. *Commissioner*, 127 F. 2d 514 (2d Cir. 1942) As a retroactive impost on distillation, this part of the tax likewise avoids invalidation as a direct tax on property.

It is not without significance that the bond which the taxpayers executed on the deposit of spirits called upon them to pay "the tax imposed by law, now or hereafter in force." Could that be called an unconstitutional bargain? We think not.

The Government also gives us the theory that the tax in question has a double aspect. The first is that of distillation, already discussed. The second is the privilege of holding spirits in bond. Taxpayers say there was no "privilege" of holding spirits in bond because they had to put the spirits there whether they would or not.[16] But they were not compelled to keep them there. They could have removed them before this new $1.50 provision became effective or

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[15] Act of March 3, 1791, c. 15, §§14, 15, 1 Stat. 203.

[16] I. R. C. 1939, §2878(a); I. R. C. 1954, §5193(a).

any other time within the eight-year period. And during the eight-year term of the bond they could have taken advantage of one of the tax avoidance plans previously mentioned. That this is a permissible type of excise on more than the bare ownership of property is indicated by *Nichol* v. *Ames*, 173 U. S. 509 (1899), where the tax was sustained upon the use of board of trade facilities. Under this theory, because the privilege is continuing, the $1.50 increase can be upheld as indirect without recourse to the permissible limits of retroactive impositions.

The argument under the due process clause is simpler. Here, the plaintiffs complain, was an exaction of five times the value of the property involved at a time when there was no market for it in which they could recover immediately the large amounts advanced. They can, the argument runs, demonstrate a complete confiscation as to the taxes paid on the whisky which subsequently evaporated and a not too slight inconvenience in bearing the burden for several years until their product could be sold. It is then contended that there is no public advantage to compensate for such an unconscionable impact upon a private interest. In fact they allege the Government is harmed by the economic problems brought about by the "force-out" clause.

However, the plaintiffs' real trouble comes not from that clause, but what is for them an unfortunate business situation. Their complaint states the reason for the unusual supply of whisky in warehouses. Prior to or at about the time of the Korean trouble the distillers began making up extraordinarily large quantities of whisky. There were two reasons for this. One was that they feared restrictions upon manufacturers of the type experienced in World War II. The other was the expectation that excise taxes would be reduced and the possibility of a cheaper product would also tend to increase consumption. Both of these expectations proved to be untrue. There was no reduction in taxes, instead there was an increase. There were no restrictions placed upon manufacturers. So the quantity of material

manufactured and stored was unusually high. In the meantime, public taste has, temporarily at any rate, changed. Much of the whisky which these plaintiffs have on hand is of a type suitable for blending with neutral spirits and unfit for use without that. And it just so happens that this blended whisky has experienced, according to the plaintiffs who should know, a diminishing demand on the part of consumers who want something else. The consequences are an oversupply and an under demand. The Government says that the plaintiffs "gambled and lost." We would not put it that way except in the sense that every business venture may be a "gamble." Our point is that the situation is one of economic conditions, not unconstitutional tax law.

If the demand for the plaintiffs' products had kept up and they could have sold this whisky as they took it out of the bonded warehouses within the time required there would be no complaint. The fact that they have had to pay a tax because they have manufactured a presently unmerchantable article cannot, we think, render unconstitutional a tax which was perfectly valid before the market changed. This situation may, as the plaintiffs assert, result in loss of taxes to the Government. Whisky poured down the drain to avoid tax payment certainly does not help the United States Treasury. And a hard-pressed, money-losing distillery cannot pay the Government as much in taxes as though it were running at a profit. Granted all this is so, the solution of it is one for the Congress, not for the courts.

The judgment of the district court will be affirmed.

A True Copy:

Teste:

Clerk of the United States Court of Appeals
For the Third Circuit

Judgment.

UNITED STATES COURT OF APPEALS,

FOR THE THIRD CIRCUIT.

No. 12,409.

SCHENLEY DISTILLERS, INC., and JOSEPH S. FINCH AND COMPANY,
Appellants,
vs.
UNITED STATES OF AMERICA.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF PENNSYLVANIA

Present:

BIGGS, Chief Judge, and
GOODRICH and MCLAUGHLIN, Circuit Judges.

JUDGMENT.

This cause came on to be heard on the record from the United States District Court for the Western District of Pennsylvania and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court in this case be, and the same is hereby affirmed.

Attest:

IDA O. CRESKOFF,
Clerk.

May 8, 1958

Appendix B.

OPINION.

IN THE UNITED STATES DISTRICT COURT,

FOR THE WESTERN DISTRICT OF PENNSYLVANIA.

SCHENLEY DISTILLERS, INC. and JOSEPH S. FINCH AND COMPANY,
Plaintiffs,

v.

THE UNITED STATES OF AMERICA,
Defendant.

Civil Action 15415.

JOHN W. McILVAINE, District Judge.

The taxpayers, Schenley Distillers, Inc., hereinafter referred to as Schenley, and Joseph S. Finch and Company, hereinafter referred to as Finch, filed a complaint against the United States of America for refund of internal revenue taxes paid on distilled spirits withdrawn from an internal revenue bonded warehouse from November 1, 1951, to September 30, 1955, in the Pittsburgh, Pennsylvania, Internal Revenue District. Their claim is in two counts.

In the first count, Finch seeks a refund of $137,151 plus interest, which is the $10.50 per proof gallon distilled spirits tax as to 13,062 proof gallons of distilled spirits which allegedly evaporated after tax payment and prior to bottling.

They alleged that the spirits involved in this claim were stored in the Internal Revenue Bonded Warehouse No. 4 at Schenley, Pennsylvania, of which Finch was the proprietor at the time of payment, and that the tax was paid by the taxpayer as warehouse proprietor.

Finch alleges that at the time it paid the tax on these spirits it had no market for them, that the tax on the dis-

tilled spirits was paid, and the spirits were withdrawn from the internal revenue bonded warehouse when they reached or were immediately approaching the age of 8 years in bond due to the provisions of law and regulations which require tax payment and withdrawal of distilled spirits within 8 years of original entry for deposit in an internal revenue bonded warehouse. It is alleged that at the time the spirits were tax-paid and withdrawn there was no market for them, and that they evaporated while being held in barrels after tax payment and before bottling. Therefore, the plaintiffs claim that they are entitled to a refund of the $137,151.

In the second count, it is alleged that the distilled spirits tax of $10.50 was paid on 26,110,000 proof gallons of distilled spirits of which 25,985,849 of the said gallons were owned by Finch and tax was paid by Finch. As to this amount, Finch claims a refund of $1.50 per gallon. Finch, in the alternative, in its capacity of warehouseman demands judgment in respect to 25,790,705 gallons on which the internal revenue tax was paid; and Schenley in its capacity as warehouseman demands judgment against the defendant in respect to 195,144 gallons on which the tax was paid. Finch as warehouseman also claims a refund as to 124,151 gallons on which the tax was paid. The basis for its claim for refund is that plaintiffs allege that when the spirits were distilled the rate of tax was $9.00 per gallon and after they had been distilled the rate was increased $1.50 per gallon to an aggregate of $10.50 per gallon. The plaintiffs allege these claims for refund are subject to certain adjustments.

The plaintiffs also allege in their complaint that they made timely claims for refund in accordance with the law and, therefore, are entitled to maintain this suit. The Government does not seriously contest these facts, and having filed a motion to dismiss the plaintiffs' complaint, must be deemed to have admitted them for the purposes of this motion. However, the plaintiffs in their complaint also make allegations that the tax is unconstitutional, being an unapportioned tax, and list their reasons therefor in Para-

graphs 20 through 29 of their complaint. They allege that the force-out provision of the law is a violation of due process as seen by Paragraphs 30 through 33 of their complaint. In Paragraphs 34 through 43, the plaintiffs set forth circumstances indicating that there has been an oversupply of distilled spirits and state the problems involved in the manufacture of distilled spirits that have been encountered since and during World War II and the Korean conflict. In Paragraphs 44 through 58, Finch alleges that it faced disastrous alternatives, and alleges what it did, and the costs it incurred complying with the internal revenue laws. In Paragraphs 59 through 66, plaintiffs allege that the force-out provision has caused disastrous consequences to them and up to the present time. In Paragraphs 67 through 76, they allege that more disastrous consequences will result in the immediate and indefinite future as a result of the force-out provision. In Paragraphs 77 through 80, they allege that they are at a competitive disadvantage with foreign producers who compete in the markets in the United States. In Paragraph 81 through 97, the plaintiffs allege that the Treasury is losing revenue because of this force-out provision.

The Government has filed a motion to dismiss the complaint and in the alternative a motion to strike. The Government urges this Court to dismiss the complaint on the grounds that the complaint fails to state a claim on which relief can be granted, that the tax statutes are constitutional and valid, and that the plaintiffs are estopped from attacking the constitutionality of the statutes because they have obtained and enjoyed provisions granted with respect to the distilled spirits bonding provisions under the statutes. It also urges dismissal because Finch, it claims, is not entitled to a refund because it paid the taxes only as a warehouseman, and finally urges that the complaint be dismissed because the plaintiffs have disregarded Rule 8(a)(2) of the Federal Rules of Civil Procedure because they allege immaterial, impertinent, and redundant matter

which cannot readily be separated from the necessary and proper allegations in the refund suit.

The complaint filed in this case consists of 107 numbered paragraphs covering 40 legal-sized pages. The Government urges that it should not be required to file an answer to such a lengthy complaint because it complains that three-fourths of the complaint contains irrelevant, immaterial, and argumentive matters. The Government points out that Rule 8(a) of the Federal Rules of Civil Procedure requires that a complaint contain a short and plain statement of the claim showing that the pleader is entitled to relief. Certainly this complaint is not a short statement of the claim. However, the plaintiffs vigorously maintain that what they have pleaded is necessary for the determination of the issue. The Government urges that the entire complaint be stricken for the failure of the plaintiffs to comply with the requirements of Rule 8(a).

Professor Moore points out that:

> "What is a 'short and plain' statement depends, of course, on the circumstances of the case. A complaint for conversion, or to recover on a note, can be stated in half a page. An anti-trust action, or an action to enjoin enforcement of an unconstitutional statute, or an interpleader action, or a stockholder's suit may require more particularity." 2 Moore's Federal Practice, §8.13, p. 1653.

Thus, it appears to this Court that what constitutes a "short and plain" statement must be determined by the type of case, the relief sought, and the situation of the parties. Each complaint must be evaluated individually.

The Government in its brief points out that the courts are somewhat reluctant to grant motions which have the effect of delaying proceedings. This is probably true, and in view of the decision that we are reaching in this case we find it unnecessary to rule on the question of whether the complaint contains a short and plain statement of the

claim showing that the pleader is entitled to relief for to do so in this case would cause considerable delay in a matter which is of utmost importance both to the plaintiffs and to the Government, both of whom desire the Court to meet the constitutional question involved. See Transcript of Argument on Motion to Dismiss, held June 19, 1957, p. 3.

The Government also urges that the Court dismiss the complaint as to Finch because it is not entitled to a refund having paid the tax only as a warehouseman. However, in the complaint it appears that Finch owned approximately 99% of the distilled spirits, that all of the spirits were stored in its warehouse, and it paid the taxes on them. Therefore, Finch was not only the warehouseman, but also the owner of the distilled spirits. So whether they have paid the taxes as warehouseman, or as owners, they paid taxes on whiskey which they owned and which was in their possession. Whether the warehouseman paid the tax in this case, or the owner paid the tax, the tax was paid by Finch who was one and the same. Accordingly, the complaint cannot be dismissed on this ground.

The Government then urges that the plaintiffs are estopped from attacking the constitutionality of the statutes because they have obtained and are enjoying privileges with respect to the distilled spirits bonding provisions.[1]

While it is true as an abstract principle of law that one who has obtained certain benefits and privileges under a statute is estopped thereafter from attacking the statute as

[1] The Government alleges that the principal privileges appertaining to the bonded status of distilled spirits are: (1) postponement of the time for payment of the tax (26 U. S. C. A. 5006(b)); (2) remission of the tax on distilled spirits lost or destroyed while in bond (26 U. S. C. A. 5011); (3) bottling in bond before tax payment, with allowance for all losses incident to bottling, and attendant labeling privileges (26 U. S. C. A. 5243); (4) exportation without payment of tax (26 U. S. C. A. 5247); (5) transfer in bond, i.e. without payment of tax (26 U. S. C. A. 5246); (6) transfer for redistillation without payment of basic tax or rectification taxes (26 U. S. C. A. 5194 (f)).

being unconstitutional, see *Callanan Road Co.* v. *United States*, 345 U. S. 507 (1953); *United States* v. *San Francisco*, 310 U. S. 16 (1940); *St. Louis Malleable Casting Co.* v. *Prendergast Co.*, 260 U. S. 469 (1923), we do not feel that that principle of law is applicable in this case. In the cases relied upon by the Government, the one attacking the constitutionality of the statute obtains something under the statute which he otherwise could not have obtained had there not been a statute. For instance, in the *Callanan* case a certificate of public convenience and necessity was permitted to be transferred. In the *San Francisco* case, the federal government granted certain privileges to the City of San Francisco, and the city wanted to keep the privileges and have the act declared unconstitutional. Whereas in the *St. Louis* case the taxpayers took advantage of the sewer system set up but did not want to pay for it. The facts of the cases which have set forth the principle on which the Government rely are clearly distinguishable for the instant case wherein the taxpayer has complied with the law, paid the taxes due in accordance with the law, and is suing for a refund in accordance with the law. While it is true there are advantages to plaintiff under this statute, certainly a mere extension of time for payment of a tax is not a benefit or privilege that forever bars a taxpayer from seeking a refund. To hold otherwise would mean that every taxpayer who asks for an extension under any tax law passed by Congress allowing for such request would do so at the peril of not being able to claim a refund if the act was declared unconstitutional. Under our society as it exists today, extensions are a commonplace if not a necessity. Taxes affect almost every member of the public. To attribute to every taxpayer the ability of a constitutional lawyer would be unrealistic. Therefore, we do not feel that the taxpayers are estopped.

We are, therefore, compelled to meet the question raised as to whether or not the force-out provision is constitutional. We are not unmindful of the rules which would

require us to avoid passing on a constitutional question. A clear statement as to these is annunciated by Mr. Justice Brandeis in his concurring opinion in *Ashwander* v. *Tennessee Valley Authority*, 297 U. S. 288 (1936).

The Government in the argument of this case stated that:

> "the constitutional question of the statute is a question of law and in the plaintiffs' briefs they do not take exception to that. It appears to us, therefore, that this case should be decided on the motion to dismiss." Transcript of Argument, Morning Session, June 19, 1957, p. 3.

The position of counsel for the plaintiff was:

> "that if the Court should in this case hold that it is—that the force out provision is a constitutional levy and does not violate either the due process clause or the unapportioned tax upon the ownership of property, I imagine that our complaint should be dismissed." Transcript of Argument, Afternoon Session, June 19, 1957, p. 11.

Turning then to the first count in the complaint, the plaintiffs urge that the tax levied is an unconstitutional property tax in that the tax was exacted solely because the property was in existence on the tax payment date, that it fell solely because it was in existence, and that the tax exacted at the end of 8 years was a direct tax on property unapportioned and, therefore, expressly forbidden. What is forbidden by the Constitution is that, "No capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration hereinbefore directed to be taken." U. S. Const. art. I, § 9, cl. 4. Therefore, the Constitution prohibits a direct tax unless it is laid in proportion to the census. However, it is significant to note that the Constitution does not tell us what is a direct tax. There-

fore, in order to determine what a direct tax is we must look at what the framers of the Constitution were thinking about when they drafted our Constitution, and the decisions of our Supreme Court; and then, of course, we must see whether the tax here is a direct tax within the meaning of the Constitution or whether it is an excise tax.

Perhaps the most authoritative source of information as to what were the thoughts of the drafters of the Constitution are found in the notes of James Madison. It is reported there that, "Mr. King asked what was the precise meaning of direct taxation. No one answered." *The Debates in the Federal Convention of 1787 Which Framed the Constitution of the United States of America,* Reported by James Madison. Hunt & Scott Editions, Oxford Press, 1920, p. 435. However, this was not the only reference to a direct tax. Alexander Hamilton had a proposed draft of the Constitution which he submitted. It provided that:

> "Taxes on lands, houses, and other real estate, and capitation taxes shall be proportioned in each State by the whole number of free persons, except Indians not taxed, and by three fifths of all other persons." See Debates in the Federal Convention of 1787, *supra,* p. 615.

There also appeared to be considerable discussion about how the proportion of direct taxes should be determined. The final draft used fewer words than Hamilton had used and provided: "No capitation, or other direct tax shall be laid, unless in proportion to the census or enumeration herein before directed to be taken." See Debates in the Federal Convention of 1787, *supra,* p. 631.

It might, therefore, seem that the convention when it used the words, "direct taxes," thought of taxes on real estate and was not thinking of taxes on personal property. This view is buttressed by the opinion of the Supreme Court in the case of *Hylton* v. *United States,* 3 Dallas 171 (1796). In that case Mr. Justice Chase said:

Opinion.

"The Constitution evidently contemplated *no taxes* as *direct taxes*, but only such as Congress could lay in *proportion to the census*. The rule of *apportionment* is only to be adopted in *such* cases where it can *reasonably* apply; and the *subject* taxed, must ever determine the application of the rule.

If it is proposed to tax any *specific article* by the rule of *apportionment*, and it would evidently create great inequality and injustice, it is unreasonable to say, that the Constitution intended *such* tax should be laid by *that* rule." *Supra*, p. 174.

Mr. Justice Paterson and Mr. Justice Iredell also pointed out that they thought that the Constitution contemplated none as direct but such as could be apportioned. Mr. Justice Chase continued in his opinion that:

"I am inclined to think, but of this I do not give a judicial opinion, that the *direct* taxes contemplated by the Constitution, are only *two*, to wit, a *capitation*, or *poll* tax, *simply*, without regard to *property, profession*, or any *other circumstance;* and a tax on LAND.—I doubt whether a tax, by a *general assessment* of *personal* property, within the *United States*, is included within the term *direct* tax." *Supra*, p. 175.

Thus, it appears that a tax on personal property was permitted within the United States until the celebrated decision in *Pollock* v. *Farmers Loan & Trust Co.*, 157 U. S. 429 (1895). Rehearing 158 U. S. 601 (1895). In that case, the Court expressly held ". . . that taxes on personal property, or on the income of personal property, are likewise direct taxes." 158 U. S. 601, 637.

Consequently, we have a serious constitutional question unless this tax is an excise.

In order to accurately determine what Congress has taxed, we should examine the statute and see where the incidence of tax falls. Congress has provided that:

> "There shall be levied and collected on all distilled spirits . . . in bond or produced in or imported into the United States an internal revenue tax at the rate of . . . on each proof gallon . . . to be paid by the distiller or importer when withdrawn from bond." 26 U. S. C. A. 2800(A)(1).[2]

It is clear then that Congress has intended to tax three things in respect to distilled spirits:

> First, a tax is imposed on all distilled spirits in bond in the United States;
>
> Second, a tax is imposed on all distilled spirits produced in the United States; and
>
> Third, a tax is imposed on all distilled spirits imported into the United States.
>
> "Excises are 'taxes laid upon the manufacture, sale or consumption of commodities within the country, upon licenses to pursue certain occupations, and upon corporate privileges.'" Flint *v.* Stone Tracy, 220 U. S. 107, 151 (1911).

They are also defined as:

> ". . . a tax imposed upon the performance of an act, the engaging in an occupation, or the enjoyment of the privilege, and that every form of tax not imposed directly upon the property must constitute an excise if it is a valid tax of any description." Lutz *v.* Arnold, 208 Ind. 480, 489, 193 N. E. 840, 843 (1935).

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[2] The present statute which was enacted on August 16, 1954, as amended, provides "there is hereby imposed on all distilled spirits in bond or produced in or imported into the United States an internal revenue tax at the rate of . . . on each proof gallon . . ." 26 U. S. C. A. 5001(A)(1).

It is clear to this Court that the tax on distilled spirits falls within the traditional definition of an excise. The tax on distilled spirits has historically always been an excise. Distilled spirits since the days of Charles II, have been the subject of excise. Pennsylvania laid an excise tax on whiskey as early as 1684. In Great Britain and Canada the term, excise officer, is used to describe the government officers who supervise the collection of distilled spirits tax. It is clear to this Court that the distilled spirits tax levied under Section 5001 of Title 26 U. S. C. A. and under Section 2800 of Title 26 U. S. C. A. is an excise tax and not a direct tax on property.

A review of the complaint filed by the plaintiffs, the exhaustive and thorough briefs, and the consideration of the illuminating argument made by counsel for the plaintiff indicate to the Court that if the force-out provision of the Internal Revenue Code in respect to distilled spirits is constitutional the plaintiffs' case is at an end. They base their entire case on the fact that the force-out provision is unconstitutional. Transcript of Argument, Morning Session, June 19, 1957, p. 38. At least insofar as the first count of their complaint is concerned, they in effect allege that the force-out provision converts what was a valid excise tax on distillation into a property tax.

The heart of the plaintiffs' contention is that they are entitled to recover because the force-out provision of the Internal Revenue Code is unconstitutional. They maintain that the tax is exacted at the end of 8 years. With this, we cannot agree. A clear reading of the statute indicates that the tax is levied when the spirits are distilled. It is only the collection of them which is postponed for 8 years, providing the spirits are placed in a bonded warehouse.

As we have previously stated, we do not feel that the tax levied is a property tax within the meaning of the Constitution. The plaintiffs rely, of course, on the case of *Dawson* v. *Kentucky Distilleries Co.*, 255 U. S. 288 (1921). However, that case is distinguishable in that there the

Supreme Court interpreted Kentucky law and here we must interpret federal law. While it is true that the principles of what may constitute a property tax might be the same, and the reasoning should be used to guide our determination, nevertheless, we hold that Congress has not attempted to tax the spirits as property but has tried to excise certain features such as production, keeping in bond, and importation.

The plaintiffs then urged that the tax is a violation of the due process clause of the Constitution and maintain that the tax is levied solely by the virtue of the force-out provision.

> ". . . the due process of law clause contained in the Fifth Amendment is not a limitation upon the taxing power conferred upon Congress by the Constitution Brushaber *v.* Union Pacific Railroad Co., 240 U. S. 1, 24. . . . That clause is applicable to a taxing statute such as the one here assailed only if the act be so arbitrary as to compel the conclusion that it does not involve an exertion of the taxing power, but constitutes, in substance and effect, the direct exertion of a different and forbidden power. . . ." Magnano Co. *v.* Hamilton, 292 U. S. 40, 44 (1934). See also Bode *v.* Barrett, 344 U. S. 583 (1953).

In passing on the constitutionality of this law, it is, of course, our duty to construe the act so as to uphold its constitutionality if possible. It is a well-settled principle that if two interpretations of a statute are possible, one destroying it, and one saving the constitutionality of the act, it is the court's duty to adopt the latter. *U. S. v. Delaware & Hudson Co.*, 213 U. S. 366 (1909). While sometimes our courts have had to make strained construction to uphold the constitutionality of the act, we do not feel that in this case any strained construction is necessary. The act in our opinion is clearly an excise tax on the production, keeping in bond, or importation of distilled spirits,

and does not violate the due process clause of the Constitution and is not levied solely by the virtue of the force-out provision.

The plaintiffs also urge that the force-out provision does not serve any revenue or public purpose, and that the plaintiffs are suffering great damages because of this provision. They urge that there is an oversupply of distilled spirits and that they had no market for the whiskey in the bonded warehouse. This they feel was caused by the force-out provision. Finch has certain alternatives it claims such as (1) paying the tax at 8 years and holding the spirits subject to evaporation; (2) exporting them without paying the tax; (3) or paying the tax and dumping the spirits on the market for whatever price they would bring; (4) or destroying the spirits or redistilling them. Finch paid the tax and held the spirits hoping to sell them later. They alleged that they lost 13,062 gallons through evaporation by following this alternative. The plaintiffs allege that the situation caused by the internal revenue laws has had disastrous consequences on the industry, forcing the prices down, and that this consequence will extend to the future.

This is the first case that has been before a court in which the force-out provision has been challenged and on which the court has to make a ruling.

Congress has attempted to set up an integrated plan for collection of internal revenue taxes. Anyone who desires to produce distilled spirits must pay an internal revenue tax. There is also an internal revenue tax on the privilege of keeping distilled spirits in bond, and there is an internal revenue tax on the importation of distilled spirits.

Congress has provided that these taxes should be paid immediately when the spirits are not deposited in a bonded warehouse, but if deposited in a bonded warehouse, the tax shall be paid at the time they are withdrawn or within 8 years from original entry. It is this that the plaintiff urges is unconstitutional.

The plaintiffs have alleged this as an arbitrary and oppressive tax. They say that they can do nothing with the whiskey that they have stored in the warehouses, that there is no market for it, and that to pay the tax is hard on them. They rely on statements by various government officials that the government's revenues would not be substantially effected if the force-out provision were not in the law. However, even assuming that the act is oppressive in respect to the plaintiff, we must remember that the power to tax is vested entirely in the legislative branch of our Government, and no matter how oppressive taxation may be the judiciary cannot interfere. *Veazie Bank* v. *Fenno*, 8 Wall 533 (1869). This tax is not so arbitrary as to be in effect an exercise of a forbidden power. *Magnano Co.* v. *Hamilton, supra.*

The Courts cannot void an act of Congress lawfully extending the taxing powers though it might appear to be exercised unwisely or oppressively, nor can they inquire into the levying of a tax within its constitutional power. *McCray* v. *United States*, 195 U. S. 27 (1904). Of course, no tax is valid which is not laid for a public purpose. *Citizens Savings & Loan Association* v. *Topeka*, 20 Wall 655 (1874).

There can be no doubt that the taxation of the production, importation, and storage of distilled spirits is within the power of Congress. The plaintiffs do not seriously contest this; in fact, they only challenge the force-out provision. There is minute regulation by statute, and provisions for prolonged governmental control. These the Supreme Court pointed out:

> "... proceed upon a recognition of the exigencies of the business. It is a matter of common knowledge that the product is not ready to be marketed for consumption when it is drawn from the still. It must undergo an aging process and for this purpose it is kept in store for several years. In laying the tax, Congress has taken this necessity into consideration permitting

> a long postponement of the required payment, the spirits meanwhile being held in charge of the Government's representative." Taney *v.* Penn Bank, 232 U. S. 174, 183 (1914).

The plaintiffs in their complaint frankly admit that the situation they are faced with, an oversupply of whiskey which is approaching a period of being kept in bond for 8 years, is one of their own doing; that is, their mistaken prediction as to the demand for whiskey. The result is that they are in a difficult position. They allege that their position is due to what they call bad legislation.

We must remember that "bad" legislation in economic effect can still be the exercise of proper legislative power. Nowhere is it more difficult or more necessary for an individual judge to exercise judicial restraint than when he is interpreting the constitutionality of what he individually may feel is unwise legislation. The question he must determine is whether Congress has the power, either express or implied, under the Constitution to act, and if so has it legally exercised that power. This is the keystone of our theory of separation of powers; this restraint is the hope of our continued constitutional government.

One of our great contributions to the science of government is this system of checks and balances including the right of judicial review. But nowhere is the thought expressed that the courts should become super-legislatures. While, of course, they must adapt the law to social realities, they must be ever vigilant that each of the three great departments of our Government remains within its own proper sphere. It may be trite but, nevertheless, true that the proper function of the legislature is to make the laws, the executive to enforce the laws, and the judicial to interpret the laws. Let it remain so.

Congress was aware of the situation facing the producers of whiskey and amended the law so as to permit the distiller to either destroy the whiskey or to redistill it

without payment of the tax. This was all the relief that Congress determined to grant the industry. They did consider extending the 8-year period of bond to as high as 20 years, but decided not to change the law to that extent. The plaintiffs urge that they are at a competitive disadvantage with foreign producers; however, whether this be true or not we do not see how the Court can do anything to remedy that situation for it is fundamental that Congress has the power to control foreign commerce and it is not a question for the courts.

Whether or not the Treasury is losing revenue because of the force-out provision does not justify the Court in striking down the law. If the desired effects are not resulting, then Congress may amend the law to bring about the results, or Congress may refuse to amend the law feeling that the results are not desirable.

We must interpret the law as it is written and cannot speculate into matters of legislative policy. The 8-year bonding provision sets the period of limitation at which the internal revenue tax must be paid. Congress may well have thought when they enacted this provision that this was the maximum period of time that the Government should wait to collect its revenues.

> "Punctuality is important to the fiscal system, and these are sanctions to assure punctual as well as faithful performance of these duties." Spies *v.* United States, 317 U. S. 492 (1943); United States of America *v.* Litman, No. 12,152, 3rd Cir. (July 8, 1957).

We hold that the force-out provision is a constitutional exercise of the taxing powers of the United States. Accordingly, the plaintiffs first claim for relief does not state a cause of action and should be dismissed.

The taxpayers urged that they should be able to recover under the second count of their complaint because the additional tax of $1.50 is an unapportioned direct tax on prop-

erty; and if it is not such a tax the basic tax is a distillation tax, and the additional tax would have to be a tax on distillation and is so retroactive as to be unconstitutional.

The Government on the other hand maintains that the additional $1.50 tax per gallon is an additional excise that can be levied under the authority of *Patton* v. *Brady,* 184 U. S. 608 (1902).

In *Patton* v. *Brady,* the Supreme Court pointed out that an excise is a tax laid without rule or principle upon consumable articles upon the process of their manufacture and upon license to sell them. In determining whether this additional $1.50 is an excise or direct tax, we have as a guide the fact that taxes on whiskey have traditionally been held to be excises since the foundation of our Government and formerly in Great Britain. We have the decisions of our Supreme Court who have judicially held the tax on distilled spirits to be an excise, and finally we can apply the common meaning of the term, "excise", to the situation that we have before us and find that it is an excise.

The tax here is a tax on distilled spirits and is imposed by the statute at a period intermediate of the commencement of manufacture and the final consumption of the article. By the clear wording of the statute, there is a tax levied on the keeping of the distilled spirits in bond. What Congress has done has been to levy a tax of $10.50 on all distilled spirits in bond. Congress in effect has raised the excise tax on distilled spirits from $9.00 to $10.50 by charging a tax of $1.50 per gallon for the privilege of keeping the distilled spirits in a bonded warehouse where they may age if the owner so desires. It is true that the basic tax is a distillation tax which was $9.00 when the distilled spirits were produced. However, when the plaintiffs determined to place their spirits in a bonded warehouse for the purpose of aging and storage, and for the purpose of not paying the tax until the spirits were removed or not before 8 years, they obtained an advantage under the revenue laws. At that moment they knew that during the long his-

tory of an excise tax on whiskey that the rate of tax had been subject to change. History had also shown the necessity of these taxes applying to all whiskey to prevent windfall profits. In fact, the very nature of the article necessitated, for the benefit of the industry, that these increases and reductions apply to both spirits to be distilled and whiskey already in bond. Congress had the authority to levy an excise on this privilege and determined to tax that privilege. The tax is not a direct tax on property, nor is it a retroactive tax on distillation. It is merely another excise intermediate of the commencement of manufacture and the final consumption of the article. Accordingly, the plaintiffs' second cause of action must be dismissed as they failed to state a claim upon which relief can be granted.

In our determination of this case and consideration of the arguments advanced by counsel for the plaintiffs, we fully recognize that the plaintiffs have distinct problems, perhaps problems that were not envisioned or could not be foreseen when Congress originally enacted the internal revenue laws. The effect of the laws today and especially the so-called force-out provision may place the plaintiffs in an unfortunate situation in which they cannot compete with foreign producers and in effect are being discriminated against. However, if there be any discrimination against them, the orderly way to eliminate this would be by legislation and not a court decision. Action by Congress would be more accommodative, would afford the whole industry an opportunity to be heard, and an opportunity to assist in the formulation of any new legislation that might be necessary. The result of any new legislation by Congress would be more likely to protect the industry and the public as a whole. Congressional action would be known in advance, and the industry could adjust to meet the changes in the law. While plaintiffs may have a complaint, their grievance should again be brought to the attention of the Congress who may in its wisdom adjust the internal revenue laws to meet the change of conditions. It is obvious that

Order.

Congress has been previously alerted to the difficulties complained of by plaintiff. The existing laws we feel are constitutional. It follows then that since this tax is within the lawful power of Congress that any change must be made by Congress and not this Court.

Order.

And Now, to wit, this 22nd day of July, 1957, it is Ordered and Directed that the motion of the defendant to dismiss the complaint should be and hereby is granted.

s/ John W. McIlvaine,
U. S. District Judge.

Appendix C.

Relevant Provisions of the Constitution of the United States, and the Internal Revenue Laws and Regulations Pertaining to Taxation of Distilled Spirits.

CONSTITUTION OF THE UNITED STATES

Article 1

SECTION 2

* * * * * *

"Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers, . . ."

* * * * * *

SECTION 9

"No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken."

* * * * * *

Fifth Amendment

"No person shall * * * be deprived of life, liberty, or property, without due process of law; . . ."

INTERNAL REVENUE LAWS AND REGULATIONS

Internal Revenue Code of 1954

SEC. 5001. Imposition, Rate and Attachment of Tax.

(a) Rate of Tax—

(1) In general.—There is hereby imposed on all distilled spirits in bond or produced in or imported into the United States an internal revenue tax at the rate of $10.50 on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon. On

and after April 1, 1955, the rate of tax imposed by this paragraph shall be $9 in lieu of $10.50.*

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(b) Time of Attachment on Distilled Spirits.—The Tax shall attach to distilled spirits, spirits, alcohol, or alcoholic spirits, within the meaning of section 5002(b), as soon as this substance is in existence as such, whether it be subsequently separated as pure or impure spirits, or be immediately, or at any subsequent time, transferred into any other substance, either in the process of original production or by any subsequent process.

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SEC. 5002. Definitions.

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(c) Proof Spirits.—For purposes of this chapter, the term "proof spirits" means that alcoholic liquor which contains one-half its volume of alcohol of a specific gravity of seven thousand nine hundred and thirty-nine ten-thousandths (.7939) at 60 degrees Fahrenheit.

(d) Proof Gallon.—For purposes of this chapter, the term "proof gallon" means a gallon of proof spirits, according to the standard prescribed in subsection (c), set forth and declared for the inspection and gauging of spirits throughout the United States.

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* When the tax rate was increased from $9.00 to $10.50 per proof gallon, effective November 1, 1951, it was provided that the $9.00 rate would become effective again on April 1, 1954. Revenue Act of 1951, §451, 65 Stat. 524. However, the 1954 Code extended such effective date for the reduction of the tax rate to April 1, 1955, and it was again extended one year by Pub. L. No. 18, 84th Cong., 1st Sess. §3 (1955), for a further year by Pub. L. No. 458, 84th Cong., 2d Sess. §3 (1956), for a further fifteen months, until July 1, 1958, by Pub. L. No. 85-12, 85th Cong., 1st Sess. §3 (1957), and for a further year, until July 1, 1959, by Pub. L. No. 85-475, 85th Cong., 2d Sess. (1958).

Relevant Provisions of the Constitution of the United States, and the Internal Revenue Laws and Regulations Pertaining to Taxation of Distilled Spirits.

SEC. 5004. Lien for Tax.

(a) Lien Applicable to Distilled Spirits.—

(1) Property subject to lien.—The tax imposed by section 5001(a)(1) shall be a first lien on the spirits distilled, the distillery used for distilling the same, the stills, vessels, fixtures, and tools therein, the lot or tract of land on which such distillery is situated, and on any building thereon, from the time such spirits are in existence as such until (except as provided in paragraph (3)) such tax is paid.

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(3) Extinguishment of lien.—Any lien under paragraph (1) on any land or any building thereon shall be held to be extinguished if (A) such land and building are no longer used for distillery purposes, (B) there is no outstanding liability for taxes or penalties imposed by law on the distilled spirits produced therein, and (C) no litigation is pending in respect of any such tax or penalty.

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SEC. 5005. Persons Liable for Tax.

(a) General.—The internal revenue tax imposed by section 5001(a)(1) on distilled spirits shall be paid by the distiller or importer.

(b) Domestic Distilled Spirits.—Every proprietor or possessor of, and every person in any manner interested in the use of, any still, distillery, or distilling apparatus, shall be jointly and severally liable for the taxes imposed by law on the distilled spirits produced therefrom.

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Relevant Provisions of the Constitution of the United States, and the Internal Revenue Laws and Regulations Pertaining to Taxation of Distilled Spirits.

SEC. 5006. Determination of Tax.

(a) Requirements.—

(1) In general.—The internal revenue tax on distilled spirits shall be determined when the spirits are withdrawn from bond. Such tax shall be determined by such means as the Secretary or his delegate shall by regulations prescribe, and with the use of such devices and apparatus (including but not limited to storage, gauging, and bottling tanks and pipelines) as the Secretary or his delegate may require.

(2) Distilled spirits deposited in internal revenue bonded warehouses.—The tax on distilled spirits entered for deposit in internal revenue bonded warehouses shall be determined at the time the same are withdrawn therefrom and within 8 years from the date of original entry for deposit therein (except that distilled spirits which on July 26, 1936, were 8 years of age or older and which were in bonded warehouses on that date, may remain therein).

(b) Excessive Loss.—If it appears at any time that there has been a loss of distilled spirits from any cask or other package deposited in an internal revenue bonded warehouse, other than the loss provided for in section 5011(a), which, in the opinion of the Secretary or his delegate, is excessive, he may require the withdrawal from the warehouse of such distilled spirits, and direct the officer designated by him to collect the tax accrued on the original quantity of distilled spirits entered into the warehouse in such cask or package, notwithstanding that the time specified in any bond given for the withdrawal of the spirits entered into warehouse in such cask or package has not expired. If such tax is not paid on demand it shall be assessed and collected as other taxes are assessed and collected.

(c) Distilled Spirits Not Bonded.—The tax on any distilled spirits, removed from the place where they were distilled and (except as otherwise provided by law) not deposited in a bonded warehouse, shall, at any time within the period of limitation provided in section 6501, when knowledge of such fact is obtained by the Secretary or his delegate, be assessed on the distiller of such distilled spirits, and payment of such tax immediately demanded and, on the neglect or refusal of payment by the distiller, the Secretary or his delegate shall proceed to collect the same by distraint. This subsection shall not exclude any other remedy or proceeding provided by law.

SEC. 5007. Collection of Tax on Distilled Spirits.

(a) Tax on Domestic Distilled Spirits.—The tax on domestic distilled spirits shall be paid in accordance with section 5061.

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SEC. 5011. Abatement, Remission, Refund and Allowance for Loss or Destruction of Distilled Spirits.

(a) Distilled Spirits Lost or Destroyed in Bond.—

(1) Extent of loss allowance.—No tax shall be collected in respect of distilled spirits lost or destroyed while in bond, except that such tax shall be collected—

(A) Theft.—In the case of loss by theft, unless the Secretary or his delegate finds that the theft occurred without connivance, collusion, fraud, or negligence on the part of the distiller, warehouseman, owner, consignor, consignee, bailee, or carrier, or the employees of any of them; and

(B) Voluntary destruction.—In the case of voluntary destruction, unless such destruction is carried out under subsection (b).

(2) Proof of loss.—In any case in which spirits are lost or destroyed, whether by theft or otherwise, the Secretary or his delegate may require the distiller or warehouseman or other person responsible for the tax to file a claim for relief from the tax and submit proof as to the cause of such loss. In every case where it appears that the loss was by theft, the burden shall be upon the distiller or warehouseman or other person responsible for the tax to establish to the satisfaction of the Secretary or his delegate that such loss did not occur as the result of connivance, collusion, fraud, or negligence on the part of the distiller, warehouseman, owner, consignor, consignee, bailee, or carrier, or the employees of any of them.

(3) Refund of tax.—In any case where the tax would not be collectible by virtue of subsection (a)(1), but such tax has been paid, the Secretary or his delegate shall refund such tax. No tax shall be remitted or refunded under this subsection where the loss occurred after the tax was determined (as provided in section 5006(a)), and the spirits withdrawn from bond.

(4) Insurance coverage.—The abatement or refund of taxes provided for by subsections (a)(1) and (3) in the case of loss of distilled spirits by theft shall only be allowed to the extent that the claimant is not indemnified against or recompensed for such loss.

(b) Voluntary Destruction.—The distiller, warehouseman, or other person responsible for the tax imposed by this chapter with respect to any distilled spirits in bond may voluntarily destroy such spirits, but only if such destruction is under such supervision, and under such regulations, as the Secretary or his delegate may prescribe.

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Relevant Provisions of the Constitution of the United States, and the Internal Revenue Laws and Regulations Pertaining to Taxation of Distilled Spirits.

SEC. 5061. Method of Collecting Tax.

(a) Collection by Return.—The taxes on distilled spirits, wines, rectified distilled spirits and wines, and beer shall be paid by return. The Secretary or his delegate shall, by regulation, prescribe the period for which such return shall be filed, the time for filing such return, the information to be shown in such return and the time for payment of such tax: Provided, however, That, notwithstanding this subsection, the taxes shall continue to be paid by stamp until the Secretary or his delegate shall by regulations provide for the payment of the taxes by return.*

* * * * * * *

SEC. 5131. Eligibility and Rate of Tax.

(a) Eligibility for Drawback.—Any person using distilled spirits, produced in a domestic registered distillery or industrial alcohol plant and on which the tax has been determined, in the manufacture or production of medicines, medicinal preparations, food products, flavors, or flavoring extracts, which are unfit for beverage purposes, on payment of a special tax per annum, shall be eligible for drawback at the time when such distilled spirits are used in the manufacture of such products as provided for in this subpart.

(b) Rate of Tax.—The special tax imposed by subsection (a) shall be graduated in amount as follows: (1) for total annual withdrawals not exceeding 25 proof gallons, $25 a year; (2) for total annual withdrawals not exceeding 50 proof gallons, $50 a year; (3) for total annual withdrawals of more than 50 proof gallons, $100 a year.

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* No regulations in this regard have been promulgated by the Secretary, and the distilled spirits tax at present continues to be paid by stamp.

Relevant Provisions of the Constitution of the United States, and the Internal Revenue Laws and Regulations Pertaining to Taxation of Distilled Spirits.

SEC. 5132. Registration and Regulation.

Every person claiming drawback under this subpart shall register annually with the Secretary or his delegate; keep such books and records as may be necessary to establish the fact that distilled spirits purchased by him and on which the tax has been determined were used in the manufacture or production of medicines, medicinal preparations, food products, flavors, or flavoring extracts which were unfit for use for beverage purposes; and be subject to such rules and regulations in relation thereto as the Secretary or his delegate shall prescribe to secure the Treasury against frauds.

SEC. 5133. Investigation of Claims.

The Secretary or his delegate, for the purpose of ascertaining the correctness of any claim filed under this subpart, is authorized, by any officer or employee of the Treasury Department, including the field service, designated by him for that purpose, to examine any books, papers, records, or memoranda bearing upon the matters required to be alleged in the claim, and may require the attendance of the person filing the claim or of any officer or employee of such person, or the attendance of any other person having knowledge in the premises, and may take his testimony with reference to any matter covered by the claim, with power to administer oaths to such person or persons.

SEC. 5134. Drawback.

(a) In the case of distilled spirits on which the tax has been determined and used as provided in this subpart, a drawback shall be allowed—

(1) At the rate of $6 on each proof gallon upon which tax is paid at a rate of $9 per proof gallon prior to November 1, 1951;

(2) At the rate of $9.50 on each proof gallon upon which tax is determined at the rate of $10.50 per proof gallon on and after November 1, 1951;

(3) At the rate of $8 on each proof gallon upon which tax is determined at a rate of $9 per proof gallon after March 31, 1955.

(b) Such drawback shall be due and payable quarterly upon filing of a proper claim with the Secretary or his delegate; except that, where any person entitled to such drawback shall elect in writing to file monthly claims therefor, such drawback shall be due and payable monthly upon filing of a proper claim with the Secretary or his delegate: Provided, however, That the Secretary or his delegate may require persons electing to file monthly drawback claims to file with him a bond or other security in such amount and with such conditions as he shall by regulations prescribe. Any such election may be revoked on filing of notice thereof with the Secretary or his delegate. No claim under this subpart shall be allowed unless filed with the Secretary or his delegate within the 3 months next succeeding the quarter in which the distilled spirits covered by the claim were used as provided in this subpart.

SEC. 5176. Distiller's Bond.

(a) Form and Approval.—Every person intending to commence or to continue the business of a distiller shall, on filing with the Secretary or his delegate his notice of such intention, and before proceeding with such business, and on the first day of May of each succeeding year, execute a bond in the form prescribed by the Secretary or his delegate, conditioned that he shall faithfully comply with all the provisions of law relating to the duties and business of distillers, and shall pay all penalties incurred or fines imposed on him for a violation of any of the said provi-

sions; and that he shall not suffer the lot or tract of land on which the distillery stands, or any part thereof, or any of the distilling apparatus, to be incumbered by mortgage, judgment, or other lien, during the time in which he shall carry on said business. Such bond shall be with such sureties, approved by the Secretary or his delegate, and for a penal sum not less than the amount of tax on the spirits that can be distilled in his distillery during a period of 15 days. Such bond shall not exceed the sum of $100,000.

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Sec. 5193. Drawing, Gauging, and Marking of Distilled Spirits.

(a) General Rule.—On or before the third working day after distilled spirits are deposited into receiving cisterns, such spirits shall be drawn off and removed as provided by law. Except as otherwise provided by law, all distilled spirits shall be drawn from receiving cisterns into casks or packages, and thereupon shall be gauged and marked under the supervision of a storekeeper-gauger, and immediately removed into an internal revenue bonded warehouse. The Secretary or his delegate is hereby empowered to prescribe all necessary regulations relating to the drawing off, gauging, and packaging of distilled spirits; the marking, branding, numbering, and stamping of such packages; and the transfer and transportation to, and the storage of such spirits in, internal revenue bonded warehouses.

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Sec. 5194 Transfer of Spirits at Registered Distilleries.

(a) Requirements.—Subject to the provisions of existing law, spirits of 160 degrees of proof or more produced at registered distilleries, including registered fruit distil-

leries, may be transferred by means of pipelines from receiving cisterns in the distillery direct to storage tanks in the internal revenue bonded warehouse located on the bonded premises where produced or located contiguous thereto, and be warehoused in such storage tanks, or they may be withdrawn from the receiving cisterns, without, or after, reduction in proof, into approved containers and transferred to any internal revenue bonded warehouse for storage therein, or they may, on determination of tax, be withdrawn in such approved containers from the cistern rooms of distilleries without being entered into an internal revenue bonded warehouse. Such spirits may be drawn into approved containers from storage tanks in an internal revenue bonded warehouse. Spirits of 160 degrees of proof, or more, may be transferred in bond in tank cars or tank trucks from cistern rooms of distilleries or from storage tanks in an internal revenue bonded warehouse and be deposited in storage tanks in any internal revenue bonded warehouse. Such spirits in tanks in internal revenue bonded warehouses distilled at or above 190 degrees of proof may be reduced to not less than 111 degrees prior to being drawn into packages. Such spirits, on determination of tax, may be withdrawn in approved containers, including pipelines to contiguous premises. Except as provided in subsections (b) and (c), such spirits may not be withdrawn for denaturation.

* * * * * * *

(f) **Redistillation of Spirits.**—Distilled spirits of any proof may be transferred in any approved container from a distillery or an internal revenue bonded warehouse to any distillery for redistillation. Such spirits may be transferred by pipeline to a distillery for redistillation from tanks in an internal revenue bonded warehouse located on such distillery premises or located contiguous thereto, or from receiving tanks in a distillery to a contiguous distil-

lery. On removal of distilled spirits to any distillery for redistillation, the consignee distiller shall assume the liability for the payment of the tax on the spirits from the time they leave the internal revenue bonded warehouse or distillery, and the tax liability on the producing distillery or the internal revenue bonded warehouseman, and the liens on the premises of the producing distiller shall cease, and the tax and liens shall become the liability of the consignee distiller: Provided, That on redistillation the redistilled spirits shall be treated the same as if the spirits had been originally produced by the redistiller, and all prior obligations as to taxes and liens shall be superseded.

. . . . . .

SEC. 5232. [Warehouse] Bond Requirements.

(a) General.—The Secretary or his delegate shall, by regulations, prescribe the form and penal sums of bonds covering distilled spirits in internal revenue bonded warehouses and in transit to and between such warehouses: Provided, That the penal sums of such bonds covering distilled spirits shall not exceed in the aggregate $200,000 for each such warehouse. Such bonds shall be conditioned (1) on the withdrawal of the spirits from the internal revenue bonded warehouse within 8 years from the date of original entry for deposit; (2) on payment of the tax on the spirits, as determined on withdrawal from the internal revenue bonded warehouse; and (3) on compliance with all provisions of law and regulations relating to the business of warehousing distilled spirits.

. . . . . .

SEC. 5247. Withdrawal of Spirits for Exportation.

(a) Entries, Bonds, and Bills of Lading.—Distilled spirits may be withdrawn from internal revenue bonded

warehouses, at the instance of the owner of the spirits, for exportation in the original casks or packages, or in packages filled from such original casks or packages, without the payment of tax, after making such entries and executing and filing with the Secretary or his delegate such bonds and bills of lading, and giving such other additional security as the Secretary or his delegate may by regulations prescribe. The bonds given under this section shall be canceled or credited upon the submission of such evidence, records and certificates indicating exportation as the Secretary or his delegate by regulations may prescribe. The bonds given under this section shall be canceled or credited upon the submission of such evidence, records and certificates indicating exportation as the Secretary or his delegate by regulations may prescribe.

SEC. 7510. Exemption from Tax of Domestic Goods Purchased for the United States.

The privilege existing by provision of law on December 1, 1873, or thereafter of purchasing supplies of goods imported from foreign countries for the use of the United States, duty free, shall be extended, under such regulations as the Secretary or his delegate may prescribe, to all articles of domestic production which are subject to tax by the provisions of this title.

SEC. 7852. Other Applicable Rules.

(a) Separability Clause.—If any provision of this title, or the application thereof to any person or circumstances, is held invalid, the remainder of the title, and the application of such provision to other persons or circumstances, shall not be affected thereby.

Relevant Provisions of the Constitution of the United States, and the Internal Revenue Laws and Regulations Pertaining to Taxation of Distilled Spirits.

Warehousing of Distilled Spirits Regulations, Title 26, Code of Federal Regulations (1954), Part 225.

SEC. 225.426. When Tax is Due and Payable. The tax on distilled spirits shall be due and payable before and at the time of withdrawal from the bonded warehouse and within 8 years from the date of original entry for deposit, except that such 8-year limitation shall not be applicable in the case of spirits which on July 26, 1936, were 8 years of age, or older, and which are in bonded warehouses.

Revenue Act of 1951.

SEC. 451. Increase in Tax on Distilled Spirits from $9 to $10.50 per Gallon.

(a) Distilled Spirits Generally.—Section 2800(a)(1) is hereby amended by striking out "$6" and inserting in lieu thereof "$10.50", and by inserting after the first sentence the following new sentence: "On and after April 1, 1954, the rate of tax imposed by this paragraph shall be $9 in lieu of $10.50."*

* * * * * *

* The rate of $6 per proof gallon referred to was in effect prior to the Revenue Act of 1943 which increased the rate to $9.00 from and after April 1, 1944 (Section 302(a), 58 Stat. 61, as amended by Excise Tax Act of 1947, Section 2, 61 Stat. 12). The Revenue Act of 1943 was not in form, however, an amendment of Section 2800(a)(1) of the Internal Revenue Code of 1939 and the rate provided for by the terms of that Section remained "$6" until the Section was formally amended by the Revenue Act of 1951 to include both the $3 increase provided for earlier and the $1.50 increase provided for in the Revenue Act of 1951 itself.

As mentioned at page 2 above, the rate reduction date has been successively extended until it is now July 1, 1959.

Relevant Provisions of the Constitution of the United States, and the Internal Revenue Laws and Regulations Pertaining to Taxation of Distilled Spirits.

Internal Revenue Code of 1939.

SEC. 2800. Tax

(a) Rate

(1) Distilled spirits generally. There shall be levied and collected on all distilled spirits in bond or produced in or imported into the United States an internal revenue tax at the rate of $10.50 on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon, to be paid by the distiller or importer when withdrawn from bond. On and after April 1, 1955, the rate of tax imposed by this paragraph shall be $9 in lieu of $10.50.

* * * * * * *

(b) Time for payment

* * * * * * *

(2) Distilled spirits not bonded. The tax upon any distilled spirits, removed from the place where they were distilled and not deposited in bonded warehouse as required by law, shall, at any time within the period of limitation provided in section 3312, when knowledge of such fact is obtained by the Commissioner, be assessed by him upon the distiller of the same, and returned to the collector, who shall immediately demand payment of such tax, and, upon the neglect or refusal of payment by the distiller, shall proceed to collect the same by distraint. But this provision shall not exclude any other remedy or proceeding provided by law.

SEC. 2878. Drawing, Gauging, and Marking of Distilled Spirits.

(a) General Rule.—Except as provided in section 2883, all distilled spirits shall be drawn from receiving cisterns into casks or packages and thereupon shall be gauged,

proved, and marked by a storekeeper-gauger, and immediately removed into an internal revenue bonded warehouse. The Commissioner, with the approval of the Secretary, is hereby empowered to prescribe all necessary regulations relating to the drawing off, gauging, and packaging of distilled spirits; the marking, branding, numbering, and stamping of such packages; and the transfer and transportation to, and the storage of such spirits in, internal revenue bonded warehouses.

* * * * * *

SEC. 2879. Deposits of Spirits in Warehouses.

* * * * * *

(b) Time for payment of the tax. The tax on all distilled spirits hereafter entered for deposit in internal revenue bonded warehouses shall be due and payable before and at the time the same are withdrawn therefrom and within eight years from the date of the original entry for deposit therein; and warehousing bonds hereafter taken under the provisions of the internal revenue laws shall be conditioned for the payment of the tax on the spirits as specified in the entry before withdrawal from the internal bonded warehouse, and within eight years from the date of said entry.

* * * * * *

SEC. 2883. Transfer of Spirits at Registered Distilleries.

(a) Requirements.—Subject to the provisions of existing law, spirits of one hundred and sixty degrees of proof or more produced at registered distilleries, including registered fruit distilleries (such registered distilleries and registered fruit distilleries being referred to hereafter as "distillery" or "distilleries"), may be transferred by

means of pipe lines from receiving cisterns in the distillery direct to storage tanks in the internal revenue bonded warehouse located on the bonded premises where produced or located contiguous thereto, and be warehoused in such storage tanks, or they may be withdrawn from the receiving cisterns, without, or after reduction in proof, into approved containers and transferred to any internal revenue bonded warehouse for storage therein, or they may be tax-paid in such approved containers in the cistern rooms of distilleries without being entered into an internal revenue bonded warehouse. Such spirits may be drawn into approved containers from storage tanks in an internal revenue bonded warehouse. Spirits of one hundred and sixty degrees of proof, or more, may be transferred in bond in tank cars from cistern rooms of distilleries or from storage tanks in an internal revenue bonded warehouse and be deposited in storage tanks in any internal revenue bonded warehouse. Such spirits in tanks in internal revenue bonded warehouses distilled at or above one hundred and ninety degrees of proof may be reduced to not less than one hundred and eleven degrees prior to being drawn into packages. Such spirits, upon tax payment, may be withdrawn in approved containers, including pipe lines to contiguous premises, for use for beverage purposes only. Except as provided in subsection (c) hereof and section 2916, such spirits may not be withdrawn for denaturation.

* * * * * *

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No. 257

In the Supreme Court of the United States

OCTOBER TERM, 1958

SCHENLEY DISTILLERS, INC. AND JOSEPH S. FINCH AND COMPANY, PETITIONERS

v.

THE UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the Court of Appeals (Pet. App. A, pp. 1–8) is reported at 255 F. 2d 334. The opinion of the District Court (Pet. App. B, pp. 1–19) is reported at 153 F. Supp. 898.

JURISDICTION

The judgment of the Court of Appeals was entered on May 8, 1958. (Pet. App. A, p. 9.) Taxpayers' petition for a writ of certiorari was filed on August 6, 1958. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254 (1).

QUESTIONS PRESENTED

1. Whether the courts below erred in holding that the federal tax on distilled spirits is a valid excise.

tax, and not an unapportioned direct tax on property or a confiscatory levy which deprives taxpayers of their property without due process of law.

2. Whether the courts below erred in reaching the same conclusions with respect to the $1.50 increase in the rate of the tax applicable to distilled spirits held in bond on November 1, 1951.

CONSTITUTION AND STATUTES INVOLVED

The pertinent portions of the Constitution of the United States (Article I, Sections 2, 8, 9, and the Fifth Amendment) and of the relevant statutes (Sections 2800, 2878, 2879, 2880, 2883, 2885, 2900, 2901 and 3070 of the Internal Revenue Code of 1939, and Sections 5001, 5004, 5005, 5006, 5011, 5012, 5061, 5193, 5194, 5232, 5242, 5246, 5247, 5248, 5331 and 7851 of the Internal Revenue Code of 1954) are set forth in the Appendix, *infra*, pages 20–38.

STATEMENT

The facts, recited below, must be considered in the light of the following basic statutory provisions. A tax on "all distilled spirits in bond or produced in * * * the United States," at the rate of $10.50 per proof gallon, was "levied" by Section 2800 (a) of the 1939 Code, and is "imposed" by its successor, Section 5001 (a) (1) of the 1954 Code. Prior to an amendment of Section 2800 (a), effective November 1, 1951, the rate of tax was $9 per proof gallon. The tax is payable, as to spirits deposited in internal revenue bonded warehouses, upon withdrawal of the spirits and within eight years from the date of deposit.

Section 2879 (b) of the 1939 Code, and Sections 5006 (a) (2) and 5061 (a) of the 1954 Code.

The material facts[1] may be summarized as follows:

Taxpayers, Schenley Distillers, Inc. (Schenley) and Joseph S. Finch and Company (Finch), are wholly-owned subsidiaries of Schenley Industries, Inc. Between November 1, 1951, and September 30, 1955, Finch paid distilled spirits taxes at the rate of $10.50 per proof gallon on more than a million proof gallons of distilled spirits (mostly whiskey) which had reached or were approaching the age of eight years in bond. These spirits were owned by Finch and at the times of payment were stored in an internal revenue bonded warehouse of which Finch was proprietor. (R. 4a, 8a.)

Finch had no market for such spirits when the tax was paid and the spirits withdrawn from bond. Thereafter, at such times as Finch was able to find a market, the spirits were bottled for marketing. Prior to bottling a total of 13,062 tax-paid gallons evaporated. (R. 8a–9a.)

---

[1] The District Court dismissed the taxpayers' complaint because, as its opinion reveals, it concluded that the complaint failed to state a claim upon which relief could be granted. Thus the material facts must be derived from the allegations of the complaint. However, it should be noted here that taxpayers' lengthy complaint (R. 3a–42a) is replete with arguments as to the meaning and effect of statutory and constitutional provisions, and factual allegations which do not relate to the damage allegedly suffered by taxpayers or to the taxes involved in this litigation. The Government's statement herein refers to such extraneous matter only so far as necessary to indicate the basic framework of taxpayers' complaint.

Together, taxpayers withdrew an aggregate of 26,110,000 proof gallons between November 1, 1951, and September 30, 1955, and paid the tax of $10.50 per proof gallon. All of these spirits were distilled prior to November 1, 1951; were stored in bonded warehouses of which taxpayers were proprietors; were owned, for the most part, by Finch; and an unspecified portion of them had reached or were approaching the age of eight years in bond, at the times of withdrawal and tax payment. (R. 36a–38a.)

In taxpayers' complaint the first claim—on behalf of Finch alone—was for refund of the total amount of tax paid (plus interest) on that portion of 1,000,000 gallons withdrawn which evaporated prior to bottling, *i. e.*, 13,062 gallons. (R. 9a.) In support of this claim taxpayers contended that the entire distilled spirits tax of $10.50 per proof gallon is a direct tax on property as to spirits deposited in bond, because it must be paid within eight years of deposit without reference to whether there is a market for the spirits, and hence that the tax (since it is unapportioned) violates Article I, Section 2, clause three, and Article I, Section 9, clause four, of the Constitution. (R. 11a-12a.)

Taxpayers further contended, in support of their first claim, that the eight-year limitation for withdrawal of whiskey from bond and payment of tax violates the Fifth Amendment's guaranty of due process. In relation to this contention the complaint set forth many factual allegations relating to damage sustained by the distilling industry in general, as well as by taxpayers, by reason of the eight-year provision

together with predictions of future damage to taxpayers and the industry. These allegations, briefly summarized, follow:

There was a mounting oversupply of spirits in bond throughout the country during the period from November 1, 1951, through September 30, 1955. Upon the outbreak of the Korean conflict in 1950, the distilling industry had embarked on high levels of production because (1) it feared renewal of wartime restrictions on production, (2) it anticipated a substantial increase in consumer demand, and (3) it hoped the tax on distilled spirits would be reduced within a few years and that such reduction would provide an additional spur to consumer demand. None of these expectations was fulfilled. (R. 13a–16a.)

Owing to the lack of a market, Finch and other distillers sustained considerable financial losses in connection with the withdrawal of spirits from bond during the period in question. (R. 23a–24a.) Taxpayers' whiskey was suitable only for blends, and the market had been steadily declining for blends and all non-Kentucky whiskey. (R. 19a, 27a–28a.) Under such unfavorable circumstances, taxpayers (like other distillers) were forced to dump their whiskey on the market for what it would bring or to redistill it. (R. 21a, 22a.)

Taxpayers further predicted that the eight-year limitation will cause great damage to the distilling industry in the indefinite future. (R. 25a–28a.) And they alleged that the losses sustained by the distilling industry were reflected in losses of revenue to the

Government and that the eight-year limitation was responsible for both. (R. 30a *et seq.*)

Taxpayers' second claim for refund related to the taxes which they paid on the withdrawal from bond of 26,110,000 gallons during the period from November 1, 1951, to September 30, 1955. This claim was not for a refund of the entire tax paid ($10.50 per proof gallon), but only for the $1.50 per gallon increase in the tax which became effective November 1, 1951 (plus interest and certain adjustments). (R. 36a–39a.) In support of this claim taxpayers incorporated by reference (R. 36a) their contention under the first claim that the entire tax was an unapportioned direct tax, and contended alternatively (R. 40a–41a) that at least the $1.50 increase was an unapportioned direct tax because of the eight-year limitation. Taxpayers also contended, in support of the second claim, that the $1.50 increase was an exaction constituting deprivation of property without due process of law, in violation of the Fifth Amendment (R. 40a–41a), and they incorporated by reference (R. 36a) their allegations under the first claim relating to due process.

In response to taxpayers' complaint, the Government filed a motion to dismiss the complaint or, in the alternative, to strike it. The District Court decided only that the complaint should be dismissed for failure to state a claim on which relief could be granted (Pet. App. B, pp. 4–5.) The Court of Appeals agreed with this conclusion. (Pet. App. A, pp. 1–8.)

ARGUMENT

Taxpayers renew here their contentions that the federal tax on distilled spirits (or at least the $1.50 increase in the rate of the tax effective in 1951) is unconstitutional, so far as it relates to spirits deposited in bond, because of the eight-year limitation for the withdrawal of such spirits from bond and payment of the tax. The courts below have rejected these contentions, holding that both the distilled spirits tax and the 1951 increase thereof constitute a valid excise. Taxpayers do not now contend that this holding is in direct conflict with any decision of this Court or of other courts. They concede (Pet. 4) that the case is one of first impression, but assert (Pet. 4, 8–13) that the decisions below are contrary to the "import" of *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429, opinion on rehearing, 158 U. S. 601, and subsequent decisions of this Court. Taxpayers err in this assertion, as shown below. And this error stems, in large part, from taxpayers' fundamental misconception of the taxing scheme with respect to distilled spirits. Contrary to their repeated assertion (Pet. 3 *et seq.*), no tax is "exacted" by the eight-year limitation; the tax is imposed by other provisions and, as will appear, the eight-year limitation is merely a permissive provision extending relief which Congress need not have granted at all.

1. A tax on production or manufacture is, of course, a classic type of valid excise and not a direct tax on the property produced or manufactured.

Flint v. *Stone Tracy Co.*, 220 U. S. 107, 151. In the opinion below, the Court of Appeals noted (Pet. App. A, p. 4) that "It is conceded that Congress could have enacted a distillation tax," *i. e.*, an excise on production. And this is precisely what Congress has done, as the courts below held, and as appears from the clear language of the statutes, their legislative history, and the unanimous construction in the decided cases.

The tax is "levied" in part on all distilled spirits "produced in" the United States. Section 2800 (a), 1939 Code (Appendix, *infra*, p. 21). Or, in the terms of the 1954 Code, the tax is "imposed" on all such spirits. Section 5001 (a) (1) (Appendix, *infra*, p. 29). The tax attaches to distilled spirits "as soon as this substance is in existence as such * * *." Sections 2800 (e), 1939 Code and 5001 (b), 1954 Code (Appendix, *infra*, pp. 22, 30). As to spirits not deposited in an internal revenue bonded warehouse, the tax must be paid at the time of distillation. Sections 2800 (b) (2), 1939 Code and 5006 (c), 1954 Code (Appendix, *infra*, pp. 22, 32).

Historically, the distilled spirits tax was first enacted expressly as an excise on distillation and (with the exception of a tax on capacity of distilleries in force from 1813 to 1817) it has retained its primary character as a distillation tax ever since.[2] This has

[2] Section 15, Act of March 3, 1791, c. 15, 1 Stat. 199; Act of July 24, 1813, c. 25, 3 Stat. 42; Section 11, Act of July 1, 1862, c. 119, 12 Stat. 432; Section 1, Act of March 7, 1864, c. 20, 13 Stat. 14; Section 55, Act of June 30, 1864, c. 173, 13 Stat. 223; Sections 1 and 4, Act of July 20, 1868, c. 186, 15 Stat. 125; Section 1, Act of March 3, 1875, c. 127, 18 Stat. 3[illegible]; Section 18, Tariff Act of 1894, c. 349, 28 Stat. 509; Sections

been repeatedly recognized by this and other courts. *United States* v. *Rizzo*, 297 U. S. 530; *United States* v. *One Ford Coupe*, 272 U. S. 321; *Thompson* v. *United States*, 142 U. S. 471; *Burke* v. *Mingori*, 128 F. 2d 996 (C. A. 10th), certiorari denied, 317 U. S. 662. The tax was specifically characterized as a "basic production tax" by this Court in *United States* v. *One Ford Coupe, supra*, p. 328, and by the Tenth Circuit in *Burke* v. *Mingori, supra*, p. 997. And as recently as December 4, 1957, in *Erie Railroad Co.* v. *United States*, 156 F. Supp. 908, the Court of Claims invoked the above-cited decisions of this Court in holding, with respect to Section 2800 of the 1939 Code (Appendix, *infra*, p. 21), that (p. 910) "the tax is one on the production of distilled spirits, and not a consumer's tax as plaintiffs insist."

As an excise on distillation, the tax could be collected at the time of distillation. However, Congress has allowed the payment of tax to be deferred in the case of certain types of spirits, provided they are deposited in bond, for the following reasons explained by this Court in *Taney* v. *Penn Bank*, 232 U. S. 174, 183–184:

> It is a matter of common knowledge that the product [whiskey] is not ready to be marketed for consumption when it is drawn from the still. It must undergo an aging process and for

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300, Revenue Act of 1917, c. 63, 40 Stat. 300; Section 600, Revenue Act of 1918, c. 18, 40 Stat. 1057. Legislation of the prohibition era and of the 1930s need not concern us here, for the basic features of the taxing scheme as developed from 1791 to 1919 were incorporated in the 1939 Code and then in the 1954 Code.

> this purpose it is kept in store for several years. In laying the tax, Congress has taken this necessity into consideration permitting a long postponement of the required payment, the spirits meanwhile being held in charge of the Government's representative. * * *

In short, the deferment of tax payment as to spirits deposited in bond is a relief provision for the benefit of the distiller and parties in interest. *United States* v. *Witten*, 143 U. S. 76, 78; *United States Fidelity & Guaranty Co.* v. *United States*, 220 Fed. 592, 594 (C. A. 4th); *Erie Railroad Co.* v. *United States*, *supra*.

The period of deferment was one year under the Act of July 20, 1868, *supra;* was extended to three years by the Joint Resolution of March 28, 1878, 20 Stat. 249; and was further extended to eight years by the Tariff Act of 1894, *supra*. Except for the prohibition era, the eight-year limitation for withdrawal of spirits from bond and payment of tax has been in effect ever since 1894. Within the past few weeks Congress has seen fit to extend the period to twenty years.[1] Whatever the period of deferment, it remains a "postponement of the required payment," in the language of *Penn Bank*, quoted above. As a valid excise on production, the tax accrues at the time of distillation—and the incidence of the tax is not altered by the eight-year limitation, or by other provisions of law which allow tax relief with respect to spirits which evaporate or otherwise are lost in speci-

[1] Excise Tax Technical Changes Act of 1958, P. L. 85-859, 72 Stat. 1275, Section 201, signed by the President on September 2, 1958.

fied ways while in bond.[5] *Erie Railroad Co.* v. *United States, supra,* p. 911. Such allowances for spirits lost while in bond are, like the eight-year limitation, simply *relief* provisions which must be strictly construed. *Farrell* v. *United States,* 99 U. S. 221; *Thompson* v. *United States,* 142 U. S. 471.

Taxpayers seek to obscure the relief character of the eight-year limitation by asserting (Pet. 5, 13) that the law "commanded" them to put their whiskey in bond. It is true that whiskies must be removed from distilleries to bonded warehouses, unlike certain other spirits. Sections 2879 (a), 2883 (a) and (d), 1939 Code (Appendix, *infra,* pp. 24, 26–27), and Sections 5193 (a), 5194 (a) and (e), 1954 Code (Appendix, *infra,* pp. 34–35). But this is simply in order that the spirits may remain under Government supervision until the tax is paid. There is no *minimum* bonding period whatever; the whiskey may be removed whenever the tax is paid. There is only a *maximum* period for postponing the payment of what is, as demonstrated above, a valid excise on distillation.

The distilled spirits tax is not only a valid excise on production; since 1894 it has also been a valid

[5] Section 2901 (a), 1939 Code (Appendix, *infra,* p. 28); Section 5011 (a), 1954 Code (Appendix, *infra,* p. 32). The 1939 Code also provided that spirits in bond shown to be unfit for beverage purposes could be voluntarily destroyed without payment of tax. Section 2901 (a) (2) (Appendix, *infra,* p. 28). The 1954 Code extended this relief, allowing voluntary destruction without regard to the quality of spirits and also allowing greater latitude in redistillation of spirits free of tax. Sections 5011 (b) and 5094 (f) (Appendix, *infra,* pp. 33, 35).

excise on the privilege of holding spirits in bond. In successive enactments prior to 1894, raising the rate of the distilled spirits tax, Congress failed to extend the new rates to existing stocks of spirits in bond. The result, as noted by the court below (Pet. App. A, p. 5), was speculation and unfair competition between owners of existing stocks and distillers of new spirits. Accordingly, Section 48 of the Tariff Act of 1894, *supra*, made the tax imposed by that Act applicable not only to spirits thereafter distilled but to all spirits in bond at the date of enactment on which no tax had yet been paid. This extension of the taxing scheme has continued in force to the present day, the tax being levied not only on spirits "produced in" the United States, but also on spirits "in bond" in the United States. Section 2800 (a), 1939 Code; Section 5001 (a) (1), 1954 Code.

In its incidence upon spirits "in bond," the tax is laid upon a substantial privilege—or rather, a bundle of privileges associated with holding spirits in bond, including the postponement of tax payment and the remission of tax as to spirits evaporated and otherwise lost while in bond. That such a privilege tax is a valid excise is abundantly confirmed by decided cases. As this Court has held, excises are not limited in incidence to manufacture and sale, but extend to vocations, occupations, and *privileges* of every description. *Steward Machine Co. v. Davis*, 301 U. S. 548, 582–583; *Thomas v. United States*, 192 U. S. 363, 370. Nor need the privilege involve an active

use of property. *Flint* v. *Stone Tracy Co., supra,* pp. 166–167, and cases there cited and discussed.*

Moreover in *Patton* v. *Brady,* 184 U. S. 608, the constitutional validity of an excise on existing stocks of tobacco was confirmed on an even broader basis, this Court upholding as well settled the validity of excises imposed (p. 617) "upon goods intended for consumption * * * *at some time intermediate the beginning of manufacture or production and the act of consumption.*" (Italics supplied.) There a floor stocks tax was imposed on the mere passive holding of tobacco for sale; here, as to spirits "in bond," it is validly imposed on the privileges associated with holding spirits in bond.

In its incidence on the privilege of holding spirits in bond, the tax accrues as of the date of deposit and only collection of the tax is deferred under the eight-year limitation provision. That provision, as already demonstrated, does not alter the nature or thrust of the tax but simply mitigates the burden which would otherwise fall upon distillers of whiskey and parties in interest if Congress required—as it certainly could—that the tax be paid forthwith upon distillation of the spirits, or upon deposit in bond.

2. The $1.50 increase in the distilled spirits tax, effective in 1951, was an increase in the *rate* of tax

Billings v. *United States,* 232 U. S. 261, and *Pierce* v. *United States,* 232 U. S. 290, cited by taxpayers (Pet. 8), construed a statute as expressly imposing a tax on the active *use* of yachts. No constitutional question was therefore reached as to an excise with respect to property not used, although other constitutional questions were raised.

imposed under the existing tax scheme, and it must be construed as an integral part of that scheme. *United States* v. *Jefferson Electric Co.*, 291 U. S. 386, 398; *United States* v. *Barnes*, 222 U. S. 513, 520–521. As already stated, the incidence of the distilled spirits tax, since 1894, has been upon distillation, and upon the privilege of holding spirits in bond.

Insofar as the $1.50 increase, like the prior rate of tax, was laid on the privilege of holding in bond, *Patton* v. *Brady*, *supra*, is controlling. There this Court sustained as a valid excise an *increase* in a floor stocks tax on *existing* stocks of tobacco. Here the impact of the tax is on holding in bond, instead of holding for sale, but the former is the same type of privilege as the latter—a passive privilege of which taxpayers continued to avail themselves for the future. Moreover, spirits in bond are certainly held and intended for ultimate sale, and the possibility that they may not actually be marketed is no more material than the possibility that, after payment of a floor stocks tax, tobacco held and intended for sale may be burned or otherwise destroyed.

Insofar as the $1.50 constituted an increase of the tax as a tax on distillation, it was imposed on a past act, but that did not transform it into a tax on something other than production or make it a tax on property. To paraphrase the holding of this Court in *Milliken* v. *United States*, 283 U. S. 15, 24, "a mere increase in the tax, pursuant to a policy of which" taxpayer were "forewarned at the time" they "elected to exercise the privilege [here of distillation], did not

change its character" as an excise. Taxpayers were forewarned of the $1.50 increase, as will appear below.

Taxpayers invoke *Dawson* v. *Kentucky Distilleries Co.*, 255 U. S. 288 (Pet. 12), but that case is inapposite. It involved a state statute which purported to impose a license tax, but which was construed by this Court as levying a tax on the removal of spirits from bond. As shown above, this Court and other courts have repeatedly recognized that the eight-year limitation provision is not a tax-levying provision but a provision which *postpones* the payment of a valid excise, for the benefit of whiskey distillers and parties in interest.[7]

3. Taxpayers are equally in error in their contention that the eight-year limitation deprives them of their property without due process of law, because the rate of tax is so high and because they had no immediate market for their eight-year old spirits. Of course the distilled spirits tax is high, but a confiscation of property does not occur simply because a tax imposes a heavy burden on taxpayers. *Flint* v. *Stone Tracy Co.*, *supra*, pp. 167, 169. And this Court has observed that liquors and tobacco are appropriate

[7] Nor, it may be added, is there any conceivable conflict with *Pollock* v. *Farmers' Loan & Trust Co.*, *supra*, where on rehearing this Court (158 U. S., pp. 622-624) expressly exempted from the scope of its decision excises laid on articles of consumption, noting with approval Alexander Hamilton's description of taxes on articles of consumption as "excises" and hence not falling into the constitutional classification of "direct" taxes. That *Pollock* is inapplicable is confirmed, if confirmation be necessary, by this Court's later decision in *Patton* v. *Brady*, *supra*, discussed in the text *supra*.

objects of the excising power because they are regarded as luxuries." *Patton* v. *Brady, supra,* p. 617.

In fact, taxpayers do not assert that the rate of tax, in and of itself, is confiscatory. The crux of their complaint is that they had no immediate market for their eight-year old spirits. But taxpayers' lack of an immediate market has no bearing on the constitutionality of the tax; in the words of the court below (Pet. App. A, p. 8), that is a matter "of economic conditions, not unconstitutional tax law."[8] As already shown, the eight-year limitation provision is a *relief* provision which mitigates, not increases, the burden of the distilled spirits tax by permitting postponement of payment for a maximum period of eight years. As also noted (*supra*, p. 10), this relief provision has just been further liberalized by Congress through legislation, made applicable to existing stocks in bond, permitting the postponement of payment of the tax for a maximum of twenty, instead of eight, years.[9]

[8] According to the allegations of taxpayers' complaint, these economic conditions were of taxpayers' own making. The oversupply of spirits resulted from mistaken calculations on the part of distillers that there would be an increase in consumer demand, a renewal of wartime restrictions on production, and a reduction of the tax rate on spirits.

[9] Taxpayers do not mention this legislation, which had not reached final enactment when they filed their petition, but they do take cognizance of other recent legislation under which, as they concede (Pet. 7), they will not be entitled to recover any of the taxes here involved so far as passed on to the consumer. The effect of this legislation is to render the amounts recoverable by taxpayers in this litigation purely conjectural—just as the magnitude of the damage they have actually sustained is

4. The $1.50 increase in the tax cannot be deemed offensive to due process. Insofar as the tax increase fell on the privilege of holding spirits in bond, there was no retroactivity. The privilege of holding in bond is a continuing one, exercisable for the future. A tax increase on the similar privilege of holding for sale was sustained in *Patton* v. *Brady, supra,* not only as a valid excise, but against objections grounded on due process.

The $1.50 increase was retroactive insofar as the distilled spirits tax is upon distillation. But it is equally valid in that respect under the rules applicable to tax increases after the taxable event, as reviewed in *Wilgard Realty Co.* v. *Commissioner,* 127 F. 2d 514, 517 (C. A. 2d), certiorari denied, 317 U. S. 655. Briefly, a retroactive tax increase is not so arbitrary as to amount to a denial of due process (1) if the time of retroactivity is relatively short or (2) if, regardless of the time element, the taxpayers were forewarned of possible tax increases at the time they subjected themselves to tax liability. The present case clearly falls within the second rule, which was enunciated in *Milliken* v. *United States,* 283 U. S. 15.

Ever since 1894 successive increases in the distilled spirits tax have been made applicable to existing

purely conjectural, even accepting the allegations of the complaint as true. So far as appears from those allegations, *all* of the 26,110,000 gallons of spirits here involved have been marketed except for (1) the 13,062 gallons which evaporated after withdrawal and tax-payment (R. 9a), and (2) 551,000 gallons redistilled by Finch in 1956 (R. 22a). There is no allegation that any of the spirits involved were poured down the drain or otherwise destroyed.

stocks of spirits in bond. As shown above, the application of these increases to existing stocks was required by "the practical necessities of an efficient system of taxation," in the language of *Int. Harvester Corp.* v. *Goodrich,* 350 U. S. 537, 547. We have also discussed the long-standing relief provisions which allow abatement of the tax for spirits evaporated in bond and lost in certain other ways. It is clear, then, that the amount of tax which will ultimately be paid on spirits deposited in bond is inherently uncertain—and has often been paid at a higher rate, on withdrawal, than the rate in effect on deposit. Thus, like the statute involved in *Swayne & Hoyt, Ltd.* v. *United States,* 300 U. S. 297, 302, the enactment of the $1.50 increase in 1951 was "free of the elements of novelty and surprise which have led to condemnation, as unreasonable and arbitrary, of other retroactive legislation."

Moreover, taxpayers not only were forewarned of possible increases in the tax rate; they bound themselves, by bonds executed when the spirits involved were deposited in bond, to pay "the tax imposed by law, now or hereafter in force." (Pet. App. A, p. 6.) This Court has held that such undertakings are binding according to their terms, since "[t]he deposit of the spirits in the warehouse was solely for the benefit of the distiller, and to enable him to give bond for the payment of the tax on the spirits, instead of paying the tax at once." *United States* v. *Witten,* 143 U. S. 76, 78. And see, *Farrell* v. *United States,* 99 U. S. 211.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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APPENDIX

Constitution of the United States:

Article I.

SECTION 2.

* * * * * * *

Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers, which shall be determined by adding to the whole Number of free Persons, including those bound to Service for a Term of Years, and excluding Indians not taxed, three fifths of all other Persons. The actual Enumeration shall be made within three Years after the first Meeting of the Congress of the United States, and within every subsequent Term of ten Years, in such Manner as they shall by Law direct. The Number of Representatives shall not exceed one for every thirty Thousand, but each State shall have at Least one Representative; and until such enumeration shall be made, the State of New Hampshire shall be entitled to chuse three, Massachusetts eight, Rhode-Island and Providence Plantations one, Connecticut five, New York six, New Jersey four, Pennsylvania eight, Delaware one, Maryland six, Virginia ten, North Carolina five, South Carolina five, and Georgia three.

* * * * * *

SECTION 8. The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States;

* * * * * *

SECTION 9.

* * * * *

No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken.

* * * * *

Fifth Amendment

No person shall * * * be deprived of life, liberty, or property, without due process of law; * * *.

Internal Revenue Code of 1939:

SEC. 2800. TAX.

(a) *Rate.*—

(1) [As amended by Sec. 533 (a) of the Revenue Act of 1941, c. 412, 55 Stat. 687; Sec. 602 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798, and Sec. 451 (a) of the Revenue Act of 1951, c. 521, 65 Stat. 452] *Distilled Spirits Generally.*—There shall be levied and collected on all distilled spirits in bond or produced in or imported into the United States an internal revenue tax at the rate of $10.50 on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon, to be paid by the distiller or importer when withdrawn from bond. On and after April 1, 1954, the rate of tax imposed by this paragraph shall be $9 in lieu of $10.50.[1]

* * * * *

[1] Prior to the amendment of Section 2800 (a) (1) by Section 451 (a) of the Revenue Act of 1951, the rate of tax prescribed in the former section was $6. But a wartime tax rate of $9 per gallon was still in effect under Section 1650 of the 1939 Code. The increase in rate to $10.50 was made effective on November 1, 1951, by Section 456 of the 1951 Revenue Act.

(b) *Time for payment.*—

(1) *Bonded distilled spirits.*—For time for payment of tax on bonded distilled spirits, see paragraph (1) of subsection (a).

(2) *Distilled spirits not bonded.*—The tax upon any distilled spirits, removed from the place where they were distilled and not deposited in bonded warehouse as required by law, shall, at any time within the period of limitation provided in section 3312, when knowledge of such fact is obtained by the Commissioner, be assessed by him upon the distiller of the same, and returned to the collector, who shall immediately demand payment of such tax, and, upon the neglect or refusal of payment by the distiller, shall proceed to collect the same by distraint. But this provision shall not exclude any other remedy or proceeding provided by law.

* * * * * *

(c) *Time of Attachment.*—The tax shall attach to distilled spirits, spirits, alcohol or alcoholic spirit, within the meaning of subsection (b) of section 2809 as soon as this substance is in existence as such, whether it be subsequently separated as pure or impure spirit, or be immediately, or at any subsequent time, transferred into any other substance, either in the process of original production or by any subsequent process.

(d) *Persons Liable.*—Every proprietor or possessor of, and every person in any manner interested in the use of, any still, distillery, or distilling apparatus, shall be jointly and severally liable for the taxes imposed by law on the distilled spirits produced therefrom.

(e) *Lien.*—

(1) *Property subject to.*—The tax shall be a first lien on the spirits distilled, the distillery used for distilling the same, the stills, vessels, fixtures, and tools therein, the lot or tract of

land whereon the said distillery is situated, and on any building thereon from the time said spirits are in existence as such until (except as provided in paragraph (3)), the said tax is paid.

(2) *Exception during term of bonds.*—No lien shall attach to any lot or tract of land, distillery, building, or distilling apparatus, under the provisions of this subsection, by reason of distilling done during any period included within the term of any bond taken under the provisions of section 2815 (b) (1) (C).

* * * * *

(l) [As added by Sec. 451 (c) of the Revenue Act of 1951, *supra*] *1951 Floor Stocks Tax.*—

(1) *Tax.*—Upon all distilled spirits upon which the internal revenue tax imposed by law has been paid, and which on the effective date of section 451 (a) of the Revenue Act of 1951, are held and intended for sale or for use in the manufacture or production of any article intended for sale, there shall be levied, assessed, collected, and paid a floor stocks tax of $1.50 on each proof-gallon, and a proportionate tax at a like rate on all fractional parts of such proof-gallon.

* * * * *

(26 U. S. C. 1952 ed., Sec. 2800.)

SEC. 2878. DRAWING, GAUGING, AND MARKING OF DISTILLED SPIRITS.

(a) *General Rule.*—Except as provided in section 2883, all distilled spirits shall be drawn from receiving cisterns into casks or packages and thereupon shall be gauged, proved, and marked by a storekeeper-

gauger, and immediately removed into an internal revenue bonded warehouse. * * *

* * * * * *

(26 U. S. C. 1952 ed., Sec. 2878.)

SEC. 2879. DEPOSITS OF SPIRITS IN WAREHOUSES.

(a) *Entry for Deposit.*—The distillers of all spirits removed to an internal revenue bonded warehouse shall enter the same for deposit in such warehouse, under such regulations as the Commissioner may prescribe. * * *

(b) *Time for Payment of the Tax.*—The tax on all distilled spirits hereafter entered for deposit in internal revenue bonded warehouses shall be due and payable before and at the time the same are withdrawn therefrom and within eight years from the date of the original entry for deposit therein; and warehousing bonds hereafter taken under the provisions of the internal revenue laws shall be conditioned for the payment of the tax on the spirits as specified in the entry before withdrawal from the internal revenue bonded warehouse, and within eight years from the date of said entry.

(c) *Bond Required.*—The Commissioner shall prescribe the form and penal sums of bonds covering distilled spirits in internal revenue bonded warehouses and in transit to and between such warehouses: *Provided*, That the penal sums of such bonds covering distilled spirits shall not exceed in the aggregate $200,000 for each such warehouse.

(d) *Renewal of Bond.*—A new bond shall be required in case of the death, insolvency, or removal of the surety or sureties, and may be required in any other contingency affecting its validity or impairing its efficiency, at the discretion of the Commissioner.

And in case the warehouseman fails or refuses to give the bond required, or to renew the same, or neglects to immediately withdraw the spirits and pay the tax thereon, or if he neglects to withdraw any bonded spirits and pay the tax thereon before the expiration of the time limited in the bond, the collector shall proceed to collect the tax by distraint, issuing his warrant of distraint for the amount of tax found to be due, as ascertained by him from the report of the storekeeper-gauger, if no bond was given, or from the terms of the bond if a bond was given. * * *

* * * * *

(26 U. S. C. 1952 ed., Sec. 2879.)

SEC. 2880. WITHDRAWAL FROM WAREHOUSE AND COLLECTION OF TAX ON SPIRITS SUBJECT TO EXCESSIVE LEAKAGE.

(a) *Power of the Commissioner.*—If it shall appear at any time that there has been a loss of distilled spirits from any cask or other package deposited in an internal revenue bonded warehouse, other than the loss provided for in section 2901 (b), which, in the opinion of the Commissioner, is excessive, he may instruct the District Supervisor of the district in which the loss has occurred to require the withdrawal from warehouse of such distilled spirits, and direct the collector to collect the tax accrued upon the original quantity of distilled spirits entered into the warehouse in such cask or package, notwithstanding that the time specified in any bond given for the withdrawal of the spirits entered into warehouse in such cask or package has not expired. If the said tax is not paid on demand, the collector shall report the amount due upon his next monthly list, and it shall be assessed and collected as other taxes are assessed and collected.

* * * * *

(26 U. S. C. 1952 ed., Sec. 2880.)

SEC. 2883 [As amended by Sec. 9 of the Act of February 21, 1950, c. 36, 64 Stat. 6]. TRANSFER OF SPIRITS AT REGISTERED DISTILLERIES.

(a) *Requirements.*—Subject to the provisions of existing law, spirits of one hundred and sixty degrees of proof or more produced at registered distilleries, including registered fruit distilleries (such registered distilleries and registered fruit distilleries being referred to hereafter as "distillery" or "distilleries"), * * * may be withdrawn from the receiving cisterns, without, or after reduction in proof, into approved containers and transferred to any internal revenue bonded warehouse for storage therein, or they may be tax-paid in such approved containers in the cistern rooms of distilleries without being entered into an internal revenue bonded warehouse. * * * Spirits of one hundred and sixty degrees of proof, or more, may be transferred in bond in tank cars * * * and be deposited in storage tanks in any internal revenue bonded warehouse. Such spirits in tanks in internal revenue bonded warehouses distilled at or above one hundred and ninety degrees of proof may be reduced to not less than one hundred and eleven degrees prior to being drawn into packages. Such spirits, upon tax payment, may be withdrawn in approved containers, including pipe lines to contiguous premises, for use for beverage purposes only. * * *

* * * * *

(d) [As amended by the Act of July 3, 1951, c. 208, 65 Stat. 114] *Transfer of Gin and Vodka.*—* * * Upon tax payment, gin and vodka of any proof may be transferred by pipe line from receiving cisterns in

distilleries, * * * to a contiguous tax-paid bottling house or rectifying plant.

* * * * * *

(26 U. S. C. 1952 ed., Sec. 2883.)

SEC. 2885. EXPORTATION OF SPIRITS WITHDRAWN FROM WAREHOUSES.

(a) *Entries, Bonds, and Bills of Lading.*—Distilled spirits may be withdrawn from internal revenue bonded warehouses, at the instance of the owner of the spirits, for exportation in the original casks or packages, without the payment of tax, under such regulations, and after making such entries and executing and filing with the collector of the district from which the removal is to be made such bonds and bills of lading, and giving such other additional security as may be prescribed by the Commissioner, with the approval of the Secretary, and bonds given under this section shall be canceled under such regulations as the Secretary shall prescribe. * * *

* * * * * *

(26 U. S. C. 1952 ed., Sec. 2885.)

SEC. 2900. DATE OF WITHDRAWAL.

(a) *General Rule.*—All distilled spirits entered prior to July 26, 1936, for deposit in a distillery, general, or special bonded warehouse, or after such date entered for deposit in an internal revenue bonded warehouse, shall be withdrawn therefrom within eight years from the date of original entry therein, except as provided in subsection (b) of this section.

(b) *Exception.*—Distilled spirits which on July 26, 1936, are eight years of age, or older, and which are in bonded warehouses, may remain therein after such date; but no allowance for loss by leakage or evaporation shall be made in the case of such spirits with respect to any period after such date: *Provided*, That

loss allowances for such spirits for the period prior to July 26, 1936, shall be made pursuant to the provisions of the Act of February 6, 1925, c. 143, 43 Stat. 808.

(26 U. S. C. 1952 ed., Sec. 2900.)

SEC. 2901 [As amended by Sec. 3 of the Act of February 21, 1950, c. 36, 64 Stat. 6]. LOSS ALLOWANCES.

(a) *Extent.*—No tax shall be collected in respect of distilled spirits lost or destroyed while in bond, except that such tax shall be collected—

(1) *Theft.*—In the case of loss by theft unless the Commissioner shall find that the theft occurred without connivance, collusion, fraud, or negligence on the part of the distiller, warehouseman, owner, consignor, consignee, bailee, or carrier, or the employees of any of them; and

(2) *Voluntary destruction.*—In the case of voluntary destruction unless the distilled spirits were unfit for use for beverage purposes and the distiller, warehouseman, or other person responsible for the tax, obtained the written permission of the Commissioner for such destruction in each case.

* * * * * * *

(c) *Refund of Tax.*—When, in any case where the tax would not be collectible by virtue of subsection (a), but such tax has been paid, the Commissioner shall refund such tax. Nothing in section 2901 as hereby amended, or as heretofore amended, shall be construed to authorize refund of the tax where the loss occurred after the tax was paid.

* * * * * * *

(26 U. S. C. 1952 ed., Sec. 2901.)

SEC. 3070. WITHDRAWAL FROM BOND TAX FREE.

(a) *For Industrial Use*—Domestic alcohol of such degree of proof as may be prescribed by the Commissioner, and approved by the Secretary, may be withdrawn from bond without the payment of internal revenue tax, for use in the arts and industries, and for fuel, light, and power, provided said alcohol shall have been mixed in the presence and under the direction of an authorized Government officer, after withdrawal from the distillery warehouse, with methyl alcohol or other denaturing material or materials, or admixture of the same, suitable to the use for which the alcohol is withdrawn, but which destroys its character as a beverage and renders it unfit for liquid medicinal purposes; * * *.

* * * * * * *

(26 U. S. C. 1952 ed., Sec. 3070.)

Internal Revenue Code of 1954:

SEC. 5001. IMPOSITION, RATE AND ATTACHMENT OF TAX.

(a) *Rate of Tax.*—

(1) *In general.*—There is hereby imposed on all distilled spirits in bond or produced in or imported into the United States an internal revenue tax at the rate of $10.50 on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon. On and after April 1, 1955, the rate of tax imposed by this paragraph shall be $9 in lieu of $10.50.

(2) *Products containing distilled spirits.*—All products of distillation, by whatever name known, which contain distilled spirits or alcohol, on which the tax imposed by law has not been paid, shall be considered and taxed as distilled spirits.

* * * * *

(b) *Time of Attachment on Distilled Spirits.*—The tax shall attach to distilled spirits, spirits, alcohol, or alcoholic spirits, within the meaning of section 5002 (b), as soon as this substance is in existence as such, whether it be subsequently separated as pure or impure spirits, or be immediately, or at any subsequent time, transferred into any other substance, either in the process of original production or by any subsequent process.

(26 U. S. C. 1952 ed., Supp. II, Sec. 5001.)

SEC. 5004. LIEN FOR TAX.

(a) *Lien Applicable to Distilled Spirits.*—

(1) *Property subject to lien.*—The tax imposed by section 5001 (a) (1) shall be a first lien on the spirits distilled, the distillery used for distilling the same, the stills, vessels, fixtures, and tools therein, the lot or tract of land on which such distillery is situated, and on any building thereon, from the time such spirits are in existence as such until (except as provided in paragraph (3)) such tax is paid.

(2) *Exception during term of bonds.*—No lien shall attach to any lot or tract of land, distillery, building, or distilling apparatus, under this subsection, by reason of distilling done during any period included within the term of any bond taken under section 5177 (b) (3).

* * * * *

(26 U. S. C. 1952 ed., Supp. V, Sec. 5004.)

SEC. 5005. PERSONS LIABLE FOR TAX.

(a) *General.*—The internal revenue tax imposed by section 5001 (a) (1) on distilled spirits shall be paid by the distiller or importer.

(b) *Domestic Distilled Spirits.*—Every proprietor or possessor of, and every person in any manner interested in the use of, any still, distillery, or distilling apparatus, shall be jointly and severally liable for the taxes im-

posed by law on the distilled spirits produced therefrom.

* * * * *

(26 U. S. C. 1952 ed., Supp. V, Sec. 5005.)

SEC. 5006. DETERMINATION OF TAX.

(a) *Requirements.*—

(1) *In general.*—The internal revenue tax on distilled spirits shall be determined when the spirits are withdrawn from bond. Such tax shall be determined by such means as the Secretary or his delegate shall by regulations prescribe, and with the use of such devices and apparatus * * * as the Secretary or his delegate may require.

(2) *Distilled spirits deposited in internal revenue bonded warehouses.*—The tax on distilled spirits entered for deposit in internal revenue bonded warehouses shall be determined at the time the same are withdrawn therefrom and within 8 years from the date of original entry for deposit therein (except that distilled spirits which on July 26, 1936, were 8 years of age or older and which were in bonded warehouses on that date, may remain therein).

(b) *Excessive Loss.*—If it appears at any time that there has been a loss of distilled spirits from any cask or other package deposited in an internal revenue bonded warehouse, other than the loss provided for in section 5011, (a), which, in the opinion of the Secretary or his delegate, is excessive, he may require the withdrawal from the warehouse of such distilled spirits, and direct the officer designated by him to collect the tax accrued on the original quantity of distilled spirits entered into the warehouse in such cask or package, notwithstanding that the time specified in any bond given for the withdrawal of the spirits entered into warehouse in such cask or package has not expired. If such tax is not paid on demand it shall be assessed and collected as other taxes are assessed and collected.

(c) *Distilled Spirits Not Bonded.*—The tax on any distilled spirits, removed from the place where they were distilled and (except as otherwise provided by law) not deposited in a bonded warehouse, shall, at any time within the period of limitation provided in section 6501, when knowledge of such fact is obtained by the Secretary or his delegate, be assessed on the distiller of such distilled spirits, and payment of such tax immediately demanded and, on the neglect or refusal of payment by the distiller, the Secretary or his delegate shall proceed to collect the same by distraint. This subsection shall not exclude any other remedy or proceeding provided by law.

* * * * *

(26 U. S. C. 1952 ed., Supp. V, Sec. 5006.)

SEC. 5011. ABATEMENT, REMISSION, REFUND AND ALLOWANCE FOR LOSS OR DESTRUCTION OF DISTILLED SPIRITS.

(a) *Distilled Spirits Lost or Destroyed in Bond.*—

(1) *Extent of loss allowance.*—No tax shall be collected in respect of distilled spirits lost or destroyed while in bond, except that such tax shall be collected—

(A) *Theft.*—In the case of loss by theft, unless the Secretary or his delegate finds that the theft occurred without connivance, collusion, fraud, or negligence on the part of the distiller, warehouseman, owner, consignor, consignee, bailee, or carrier, or the employees of any of them; and

(B) *Voluntary destruction.*—In the case of voluntary destruction, unless such destruction is carried out under subsection (b).

* * * * *

(3) *Refund of Tax.*—In any case where the tax would not be collectible by virtue of subsection (a) (1), but such tax has been paid, the

Secretary or his delegate shall refund such tax. No tax shall be remitted or refunded under this subsection where the loss occurred after the tax was determined (as provided in section 5006 (a)), and the spirits withdrawn from bond.

* * * * * * *

(b) *Voluntary Destruction.*—The distiller, warehouseman, or other person responsible for the tax imposed by this chapter with respect to any distilled spirits in bond may voluntarily destroy such spirits, but only if such destruction is under such supervision, and under such regulations, as the Secretary or his delegate may prescribe.

* * * * * * *

(26 U. S. C. 1952 ed., Supp. V, Sec. 5011.)

SEC. 5012. DRAWBACK.

(a) *Drawback on Exportation of Distilled Spirits in Distillers' Original Packages.*—Distilled spirits on which all taxes have been paid may be exported, with the privilege of drawback, in distillers' original casks or packages containing not less than 20 wine gallons each, on application of the owner thereof to the Secretary or his delegate, under such regulations and on the filing of such bonds, reports, returns and applications and the keeping of such records as the Secretary or his delegate may prescribe. * * *

* * * * * * *

(26 U. S. C. 1952 ed., Supp. V, Sec. 5012.)

SEC. 5061. METHODS OF COLLECTING TAX.

(a) *Collection by Return.*—The taxes on distilled spirits * * * shall be paid by return. The Secretary or his delegate shall, by regulation, prescribe the period for which such return shall be filed, the time for filing such return, the information to be shown in such return and the time for payment of such tax: *Provided, how-*

ever, That, notwithstanding this subsection, the taxes shall continue to be paid by stamp until the Secretary or his delegate shall by regulations provide for the payment of the taxes by return.

* * * * * *

(26 U. S. C. 1952 ed., Supp. V, Sec. 5061.)

SEC. 5193. DRAWING, GAUGING, AND MARKING OF DISTILLED SPIRITS.

(a) *General Rule.*—* * * Except as otherwise provided by law, all distilled spirits shall be drawn from receiving cisterns into casks or packages, and thereupon shall be gauged and marked under the supervision of a storekeeper-gauger, and immediately removed into an internal revenue bonded warehouse. * * *

* * * * * *

(26 U. S. C. 1952 ed., Supp. V, Sec. 5193.)

SEC. 5194. TRANSFER OF SPIRITS AT REGISTERED DISTILLERIES.

(a) *Requirements.*—Subject to the provisions of existing law, spirits of 160 degrees of proof or more produced at registered distilleries * * * may be withdrawn from the receiving cisterns, without, or after, reduction in proof, into approved containers and transferred to any internal revenue bonded warehouse for storage therein, or they may, on determination of tax, be withdrawn in such approved containers from the cistern rooms of distilleries without being entered into an internal revenue bonded warehouse. * * *

* * * * * *

(c) *Transfer of Gin and Vodka.*—

(1) *To contiguous premises.*—* * * On determination of tax, gin and vodka of any proof may be transferred * * * to a contiguous tax-paid bottling house or rectifying plant.

* * * * * *

(f) *Redistillation of Spirits.*—Distilled spirits of any proof may be transferred in any approved container from a distillery or an internal revenue bonded warehouse to any distillery for redistillation. * * * on redistillation the redistilled spirits shall be treated the same as if the spirits had been originally produced by the redistiller, and all prior obligations as to taxes and liens shall be superseded.

* * * * *

(26 U. S. C. 1952 ed., Supp. V, Sec. 5194.)

SEC. 5232. BOND REQUIREMENTS.

(a) *General.*—The Secretary or his delegate shall, by regulations, prescribe the form and penal sums of bonds covering distilled spirits in internal revenue bonded warehouses and in transit to and between such warehouses: *Provided,* That the penal sums of such bonds covering distilled spirits shall not exceed in the aggregate $200,000 for each such warehouse. Such bonds shall be conditioned (1) on the withdrawal of the spirits from the internal revenue bonded warehouse within 8 years from the date of original entry for deposit; (2) on payment of the tax on the spirits as determined on withdrawal from the internal revenue bonded warehouse; and (3) on compliance with all provisions of law and regulations relating to the business of warehousing distilled spirits.

* * * * * *

(c) *Renewal Required in Certain Cases.*—New bonds shall be required in case of the death, insolvency, or removal of the surety or sureties, and may be required in any other contingency affecting its validity or impairing its efficiency, at the discretion of the Secretary or his delegate. In case the warehouseman fails or refuses to give the bond required, or to renew the same, or neglects to immediately withdraw the spirits and pay the tax thereon, or if he neglects to withdraw any bonded spirits and

pay the tax thereon before the expiration of the time limited in the bond, the Secretary or his delegate shall proceed to collect the tax.

* * * * * *

(26 U. S. C. 1952 ed., Supp. V, Sec. 5232.)

SEC. 5242. DEPOSIT OF SPIRITS IN WAREHOUSES.

(a) *General.*—The distillers of all spirits removed to an internal revenue bonded warehouse shall enter the same for deposit in such warehouse, under such regulations as the Secretary or his delegate may prescribe. * * *

* * * * * *

26 U. S. C. 1952 ed., Supp. V, Sec. 5242.)

SEC. 5246. TRANSFERS OF SPIRITS IN BOND.

(a) *General.*—Distilled spirits may be transferred in bond between internal revenue bonded warehouses in original packages or in such other packages or containers and under such regulations as the Secretary or his delegate may by regulations prescribe.

* * * * * *

(26 U. S. C. 1952 ed., Supp. V, Sec. 5246.)

SEC. 5247. WITHDRAWAL OF SPIRITS FOR EXPORTATION.

(a) *Entries, Bonds, and Bills of Lading.*—Distilled spirits may be withdrawn from internal revenue bonded warehouses, at the instance of the owner of the spirits, for exportation in the original casks or packages, or in packages filled from such original casks or packages, without the payment of tax * * *

* * * * * *

(26 U. S. C. 1952 ed., Supp. V, Sec. 5247.)

SEC. 5248. WITHDRAWAL OF SPIRITS WITHOUT PAYMENT OF TAX.

(1) For provisions relating to withdrawal of spirits, without payment of tax, to manufacturing bonded warehouses, see section 5522.

(2) For provisions relating to withdrawal of spirits, without payment of tax, as supplies for certain vessels and aircraft, see 19 U. S. C. 1309.

(3) For provisions authorizing regulations for withdrawal of spirits, without payment of tax, for use of United States, see section 7510.

(4) For provisions relating to withdrawal of distilled spirits, without payment of tax, to foreign-trade zones, see 19 U. S. C. 81c.

* * * * *

(26 U. S. C. 1952 ed., Supp. V, Sec. 5248.)

SEC. 5331. WITHDRAWAL FROM BOND FREE OF TAX.

(a) *For Industrial Use—*

(1) *Denaturation required.*—Domestic alcohol of such degree of proof as may be prescribed by the Secretary or his delegate, may be withdrawn from bond without the payment of internal revenue tax, for use in the arts and industries, and for fuel, light, and power, provided such alcohol shall have been mixed in the presence and under the direction of an authorized Government officer, after withdrawal from the distillery warehouse, with methyl alcohol or other denaturing material or materials, or admixture of the same, suitable to the use for which the alcohol is withdrawn, but which destroys its character as a beverage and renders it unfit for liquid medicinal purposes; * * *.

* * * * *

(26 U. S. C. 1952 ed., Supp. V, Sec. 5331.)

SEC. 7851. APPLICABILITY OF REVENUE LAWS.

* * * * * *

(b) *Effect of Repeal of Internal Revenue Code of 1939.*—

(1) *Existing rights and liabilities.*—The repeal of any provision of the Internal Revenue Code of 1939 shall not affect any act done or any right accruing or accrued, or any suit or proceeding had or commenced in any civil cause, before such repeal; but all rights and liabilities under such code shall continue, and may be enforced in the same manner, as if such repeal had not been made.

* * * * * *

(26 U. S. C. 1952 ed., Supp. V, Sec. 7851.)

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1958

No. 257.

SCHENLEY DISTILLERS, INC. and JOSEPH S. FINCH AND COMPANY,

Petitioners,

against

THE UNITED STATES OF AMERICA,

Respondent.

REPLY BRIEF FOR PETITIONERS SCHENLEY DISTILLERS, INC. AND JOSEPH S. FINCH AND COMPANY.

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PETITIONERS' REPLY BRIEF.

This case raises a fundamental issue of constitutional law, never before passed upon by the courts; and the settlement of that important issue, by this Court, is of deep concern to a large segment of the American business public. The Petition shows this, and the government's answering brief suggests no doubt about it.

It is equally clear, the Petitioners respectfully submit, that that basic issue was wrongly decided below. The Petition demonstrated in detail that the arguments adopted by the Court of Appeals in its opinion, in sustaining the additional $1.50 tax, are devoid of any reality in law or in fact. And the government attorneys in their answering brief, apparently doubtful about the arguments adopted in the opinion below, now advance the startling proposition that the constitutional prohibition against the levy of any fed-

eral unapportioned direct tax on property applies only to some property, and not to all, as expressly held by this Court in the *Pollock* case.* The government attorneys assert that if the personal property happens to be consumable, it is not protected. They rely upon *Patton* v. *Brady*, 184 U. S. 608 (1902), the inapplicability of which had been so thoroughly demonstrated before the Court of Appeals that it was not even cited in that Court's opinion.

1. The major issue in this case is whether the additional $1.50 tax, enacted long after the whiskey had been distilled and exacted at an arbitrary date totally unrelated to any excisable transaction or event, was an unconstitutional direct tax on the property.

The "distillation tax" theory, to which the government's brief is largely directed, has no bearing with regard to that additional $1.50 tax. That tax was not put on the books until long after the spirits had been distilled; nor was such increased tax then "foreseeable". The complaint sets forth facts demonstrating in detail that what was foreseeable was a tax *decrease*, not an increase. Thus the additional $1.50 tax cannot be sustained, as in the opinion below, as a "retroactive" tax on "distillation".

2. Nor can the additional $1.50 tax be upheld, as in the opinion below, as an excise of the "privilege" of "holding" spirits in bond. The wholly theoretical nature of the opinion below on that point is confirmed by the inability of the government attorneys to face the facts, clearly set forth at pages 12-13 of the Petition, that

> (a) There was no tax on "holding". The amount of the tax bore no relation to the time the spirits were held in bond.

* *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429 (1895); rehearing, 158 U. S. 601 (1895).

(b) This very point was decided, contrary to the conclusion of the Court below in this present case, in the unanimous decision of this Court in *Dawson* v. *Kentucky Distilleries Co.*, 255 U. S. 288 (1921).

(c) The holding of whiskey in bond is in no sense a "privilege". The law commanded the petitioners to put their whiskey in the warehouse, and it commanded them, in all practical effect, to keep it there until they had a market. The whiskey could not conceivably have been withdrawn before the November 1, 1951 effective date of the $1.50 tax, and that tax thus avoided: the aggregate of all the net assets of the entire industry would have been sufficient to pay but a minute fraction of the tax. There was no choice. There was no "privilege."

3. Thus unable to advance any support for the grounds upon which the Court below placed its decision, the government attorneys are forced to the proposition that the Constitution prohibits only some unapportioned direct taxes, and not all. Consumable articles, they say, are in a class apart, and not protected against unapportioned direct taxes.

The Constitution contains no words of limitation or exception. The apportionment requirement, set out in the Constitution once affirmatively* and again negatively,** applies without qualification to all "direct taxes." This Court has recognized no exception. On the contrary, this Court's conclusion in the *Pollock* case was flatly that "taxes on personal property [as well as real property] are likewise direct taxes."*** And in that case this Court specifically referred to consumable articles, such as "products of the farm," as property upon which no unapportioned direct tax could be levied.****

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* Article I, Section 2, Clause 3.

** Article I, Section 9, Clause 4.

*** 158 U. S. at page 637.

**** 158 U. S. at page 627.

Nor does the *Patton* case, cited by the government attorneys in support of their novel proposition, afford any support for it. The *Patton* tax was a classic example of an indirect tax, paid by one and borne by another. It was levied on goods that had been voluntarily withdrawn from bond for marketing, and it was levied in circumstances where it was perfectly clear that the tax would be passed on by the wholesaler and ultimately to the consumer. The tax was upheld as an indirect or excise tax, not because the goods were consumable, but because the tax was levied in circumstances where it would be passed on to and thus borne indirectly by another.

Another example of a classic type of indirect tax was the floor stocks tax levied on whiskey at the same time that the additional $1.50 tax was enacted in 1951. That floor stocks tax was applicable to whiskey which had been voluntarily withdrawn from bond and tax-paid at the earlier and lower rate, and it was payable by wholesalers and retailers then holding the goods for sale.* Obviously, in those circumstances, the tax was going to be passed on to the consumer and thus operate as an indirect or excise tax.

The *Patton* tax, and the floor stocks tax on whiskey, are a far cry from the tax here challenged. These goods were not and never had been on their way to market. There was no market for them. They were simply being held by the owner in a warehouse. It was a foregone conclusion, at the very time the tax was exacted, at the arbitrary force-out date, that the tax would not and could not be passed on. Its impact upon the property itself was direct and inescapable.

The petitioners respectfully submit that this Court, having so categorically confirmed the unqualified Con-

* Revenue Act of 1951, Section 451(c), 65 Stat. 525.

stitutional mandate in the *Pollock* case, should not countenance the carving out of this unwarranted exception.

Conclusion.

As shown in the Petition and in this reply brief, the fundamental issue of constitutional law involved in this case is novel and important, and it was incorrectly decided below. The Petition should be granted.

Respectfully submitted,

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Dated: September 1958